TC02666

Appeal number: TC/2012/07400

"INCOME TAX - payments treated as earnings - employee share option - gain on purported exercise by employee - "due amount" of tax accounted for to HMRC by employer - whether "due amount" to be treated as earnings of employee - no - IT(EP)A 2003 s.222"

FIRST-TIER TRIBUNAL
TAX CHAMBER

BENEDICT MANNING **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: SIR STEPHEN OLIVER QC
MARK BUFFERY FCA AIIT

Sitting in public in London on 3 April 2013

The Appellant in person

Mrs KM Evans, Appeals and Reviews, for the Respondents

DECISION

1. The Appellant, Mr Manning, appeals against an assessment for tax chargeable of £16801.20 for the year 2007/8. The assessment was made under section 222 of IT (Earnings and Pensions) Act 2003 ("the Act").

2. The tax chargeable represents income tax (referred to as "the section 222 tax") on the tax accounted for by Mr Manning's employer under PAYE (referred to as "the PAYE tax") following the purported exercise by him, in 2007/7, of an "employment-related securities option". The PAYE tax arose under section 700 of the Act in respect of the gain realised by Mr Manning when he exercised his option on 28 October 2007.

3. The reason for the assessment of the section 222 tax is that Mr Manning should have paid an amount equal to the PAYE tax to his employer (an IT company called Tradedoubler Limited) within 90 days of exercising his option. As HMRC saw the position, he paid it 76 days late.

4. Section 222 is headed "***Payments by employer on account of tax where deduction not possible".*** So far as is relevant the section reads:

> (1) This section applies if -
>
> (a) an employer is treated by virtue of section … 700 as having made a payment of income of an employee ("the notional payment"),
>
> (b) the employer is required by virtue of section 710(4) to account … for an amount of income tax ("the due amount") in respect of the notional payment, and
>
> (c) the employee does not, before the end of the 90 days beginning with the relevant date, make good the payment to the employer.
>
> (2) The due amount is to be treated as earnings from the employment for the tax year in which the relevant date falls.
>
> (3) …
>
> (4) In this section "the relevant date" means –
>
> (a) …
>
> (b) … the date on which the employer is treated as making the notional payment.

5. Tradedoubler Limited is part of a Swedish group of companies. Some years ago it established a securities option scheme for its employees. Options, described as "warrants", were granted to Mr Manning, as an employee, and the present appeal is concerned with the rights he exercised during the year 2007/8.

6. The Scheme Rules were published in 2002. (On 25 July 2012, Mr Manning lodged, with his Grounds of Appeal, a statement of his case and single page taken from the Scheme Rules to which we now refer.) Article 7.1 of the Rules provides that -

> *"It is a condition of the exercise of the …Warrant that Participant … will … deliver cash or a check to the Employer sufficient to pay the PAYE tax due …."* Article7.2 adds as a condition that – "*Participant will ensure that …cleared funds will be provided to the Employer … within 30 days of the exercise of the Warrant or, if earlier, within 14 days of the end of the tax month during which the exercise of the Warrant occurred"*

7. Article 7.3 of the Scheme Rules directs that –

> *"The question whether PAYE is to be accounted for, and, if so, the amount due on the exercise … shall be determined by the Employer having regard to the prevailing legislation and practice, any available relief for Secondary Contributions that are payable by the Participant by virtue of Article 8 and rates of income tax in force at the time. The Employer's determination shall be final and binding on Participant".*

8. On 28 October 2007 Mr Manning notified Tradedoubler Limited of the exercise of his "warrants" (to use the terminology of Article 7) over 7998 shares. He paid £7636. The market value of the 7998 shares was then £111579. We assume (though there is no evidence of this) that Tradedoubler Limited duly accounted to HMRC, in respect of the gain, for the PAYE tax and the NIC contributions in their November 2007 returns. We accept Mr Manning's evidence that Tradedoubler Limited did not notify him of its "final and binding determination of the amount of PAYE due" required by Article 7.3 by the end of the 30 day period referred to in Article 7.2.

9. Had the warrants become unconditionally exercised on 28 October 2007 (a matter to which we return later), the "relevant date" for purposes of section 122(1)(b)and(c) would have been 28 October 2007. The 90 day period for Mr Manning to "make good the amount due to" Tradedoubler Limited would, on the same basis, have ended on 26 January 2008.

10. Neither Mr Manning nor the other employees who had sought to exercise their own warrants were given any formal notification, under Article 7.3, of the determination of the amount of PAYE due. The first notification Mr Manning received was by email from Tradedoubler Limited at 8.58 am on 28 March 2008. This simply said that he appeared not to have paid the outstanding debt for his tax and NIC relating to the 2007 exercise of warrants. He replied within two hours explaining that that had been the first communication he had received about it and that he did not know how much he owed or the details of how to make the payment. Within a further two hours, he received an apology from Tradedoubler Limited and the words –

"*Please find the calculation of gain per option as well as the payroll calculation of the tax and NIC with the total withholding*".

On 11 April 2008 Mr Manning paid to Tradedoubler Limited an amount equal to the PAYE tax.

11. In 2011 HMRC conducted an audit into Tradedoubler Limited's PAYE compliance. HMRC formed the view, on the basis that 28 October 2007 had been the "relevant date", that Mr Manning's payment of the "amount due" had been made more than 90 days later. On 8 March 2012 the assessment appealed against, i.e. for the section 122 tax, was issued. (By then, the value of the shares obtained by Mr Manning on exercise of the warrant (on 28 October 2007) had dropped to less than the amount he paid for them.)

12. Mr Manning argued that the assessment produced a penal result. It worked out, in his case, to be a penalty of over £1500 per week or £220 per day. In the circumstances, he said, HMRC had a discretion that should have been applied in the interests of fairness and even-handedness.

13. HMRC, represented by Mrs Evans of HMRC's "Appeals and Reviews", pointed out that the facts of the case were clear, the application of section 222 was "mechanistic in nature" and, on that basis, the charge was properly to be assessed.

14. We, in common with Lord Neuberger MR (as he then was) in *Chilcott and others v Revenue and Customs Commissioners* [2010] EWCA Civ 1538 and [2011] STC 456, acknowledge of the effect of section 222 that "in some circumstances its meaning could at least … be regarded as penal…" That does not, however, enable us to rewrite the statutory provision. Nor do we have any authority to "judicially review" the manner in which HMRC have exercised their powers to assess. However, as Lord Neuberger observed in paragraph 31 of the *Chilcott* decision:

> "The fact that some might regard the operation of section 144A [the predecessor of section 222], according to its terms, as penal merely emphasises that the court should construe it with care and if there is a narrower construction less beneficial to the Revenue, but more beneficial to the taxpayer, available to the taxpayer, the court should at least seriously consider it and, if appropriate, adopt it."

Section 222 of the Act is not just penal in its effect, it operates as a charging section. Where it applies, it brings into charge to tax notional amounts that would otherwise have no place in the taxing system. We need, therefore, to be satisfied that the words of charge fairly cover the circumstances in which Mr Manning came to acquire his shares in Tradedoubler Limited.

15. Since the hearing we have considered the construction of the section in the light of the evidence and the documentation before us. We note from the Scheme Rules that the exercise of the option contained in the warrant is "conditional". What that

means is that the shares to which the warrant relates do not become the employee's until he or she satisfies the condition of delivering cash or a "check" sufficient to pay the PAYE tax due within 30 days. Correspondingly, Tradedoubler Limited's obligation to satisfy the exercise of the warrant (and issue the 7998 shares) is conditional on the delivery of cash or a "check" for that amount to Tradedoubler Limited within 30 days. As we read Article 7, it was drafted in terms that ensured that the employee exercising a warrant did not obtain a beneficial interest in the relevant shares until he had made good the full amount of the PAYE tax due. Mr Manning did not, as an admitted fact, satisfy that condition, presumably because Tradedoubler Limited had failed to determine the amount of PAYE due.

When was the "relevant date"?

16. Section 222(4)(b) defines this as "the date on which the employer is treated as making the notional payment". The date of the notional payment is (as the result of sections 222(1)(a),472(1), 477(3)(a) and 700) the date of "acquisition of securities pursuant to the employment-related securities option". Section 477(4) provides that this is the time "when a beneficial interest is acquired".

17. The effect of Article 7 is for the beneficial ownership of the shares to which the warrant relates to be held in suspense until the employee in question has satisfied the condition of paying the PAYE tax due within 30 days of the exercise of the warrant (or by the earlier date provided for in Article 7.2). Because of Mr Manning's failure to pay by then (due to Tradedoubler Limited's failure to notify him of its determination of the PAYE due), his rights lapsed and Tradedoubler Limited ceased to be under an obligation to vest the beneficial ownership of the 7998 shares in Mr Manning. 28 October 2007 cannot, therefore, have been the "relevant date".

18. We know that Tradedoubler Limited came back to Mr Manning on 28 March 2008 and, with due apologies, provided him with its calculation of the gain per option and "the payroll calculation of the tax and NIC with the total withholding". Mr Manning paid the due amount to Tradedoubler Limited on 11 April 2008. As we interpret the arrangements, they amounted to Mr Manning exercising the option on 28 March 2008. The contract to acquire the 7998 shares went unconditional on 11 April. On that basis 28 March 2008 became the "relevant date" and Mr Manning "made good the amount due" from him to Tradedoubler Limited well within the 90 period.

19. That resolves the appeal in favour of Mr Manning.

A Warning

20. Section 222 was introduced to prevent grossly abusive schemes designed to avoid PAYE tax and NICs. There was nothing remotely abusive about Tradedoubler Limited's share option scheme. It was designed, as we have already observed, to make sure that every employee exercising an option under the scheme made good to Tradedoubler Limited every penny of the PAYE tax due within 30 days. And yet HMRC conducted their PAYE investigation without apparently troubling to look at

the Scheme Rules. Nor did the assessing officer nor did the officer who conducted the review. The result is that, unless Mr Manning had appealed, HMRC would have earned a substantial windfall gain at his expense. We understand that Mr Manning was already heavily out of pocket as the result of his participation in the option scheme and that the assessment has caused worry and stress for him. We understand also that Mr Manning was not the only employee of Tradedoubler Limited to have suffered the same fate. When Parliament introduced section 222, they expected it to be properly and carefully exercised. The section is not, as HMRC sought to argue in this appeal, "mechanistic in effect". We echo the concerns expressed by Lord Neuberger in *Chilcott.*

21. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

SIR STEPHEN OLIVER QC
TRIBUNAL JUDGE

RELEASE DATE: 19 April 2013