Neutral Citation: [2024] UKFTT 00300 (TC)

Case Number: TC09129

FIRST-TIER TRIBUNAL
TAX CHAMBER

Taylor House, London

Appeal reference: TC/2021/16264

INCOME TAX – award made to Appellant pursuant to long-term incentive plan – Appellant became non-UK resident after cessation of employment – whether payment (received after employment ceased) was taxable as general earnings – whether payment should be apportioned to non-resident part of split year – held – payment taxable as general earnings for period of employment – appeal dismissed

Heard on: 14 November 2023
Judgment date: 2 April 2024

Before

TRIBUNAL JUDGE JEANETTE ZAMAN
TRIBUNAL MEMBER MOHAMMED FAROOQ

Between

MICHAEL SAUNDERS

Appellant

and

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Michael Firth KC, counsel, instructed by the Appellant

For the Respondents: Georgia Hicks, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs

DECISION

INTRODUCTION

1. Mr Saunders received a payment of £1,236,956 (the "Payment") from Hibernia Atlantic UK Ltd ("HAUKL"), his former employer, pursuant to an award of stock appreciation rights ("SARs"). The payment was received in January 2017, and Mr Saunders' employment had ended on 31 July 2016 and he had been non-resident in the UK since August 2016. Mr Saunders prepared his self-assessment return for 2016/17 on the basis that the Payment was not taxable in the UK. HMRC issued a closure notice making amendments to this return on the basis that the Payment was taxable income in the UK. Mr Saunders appealed to the Tribunal against that closure notice and the amendments made thereby.

2. For the reasons set out below, the appeal is dismissed. We have concluded that the Payment was earnings from Mr Saunders' employment and is not excluded earnings.

3. We appreciated the written and oral submissions of counsel for both parties, and have taken account of all of the submissions made in reaching our decision. We have named Michael Firth KC as representing Mr Saunders at the hearing. We recognise that Mr Saunders had initially instructed Joseph Howard and Mr Howard had served a skeleton argument dated 19 June 2023 (ahead of a hearing which was listed for July 2023 but postponed). It was that skeleton argument which we had before us for Mr Saunders. Mr Howard was not available to represent Mr Saunders at the re-scheduled hearing on 14 November 2023 – Mr Firth was then instructed on short notice and appeared before us. Georgia Hicks had been instructed by HMRC throughout.

STATEMENT OF AGREED FACTS

4. The parties had prepared a statement of agreed facts ("SOAF"), paragraphs of which are referred to in this decision as, eg, SOAF[1]. We adopt the definitions used therein throughout this decision. The SOAF provides as follows:

> "1. The Appellant was employed by Hibernia Atlantic UK Ltd ("HAUKL") between 2 April 2008 and 31 July 2016.
>
> 2. Throughout the period of employment, the Appellant worked in, and was resident in, the UK. HAUKL was likewise resident, with a permanent base, in the UK.
>
> 3. On 14 March 2013, the board of Hibernia Group ehf (HAUKL's parent company registered and incorporated in Iceland) adopted the Hibernia Group ehf 2013 Long Term Incentive Plan (the "Hibernia LTI Plan").
>
> 4. On 4 April 2013, the Appellant entered into an Agreement for Stock Appreciation Rights with Hibernia Group ehf (the "SAR Agreement"). Pursuant to the SAR Agreement the Appellant was granted: (1) 157,887 SARs at a grant price of $1.32; and (2) 291,667 SARs at a grant price of $1.38.
>
> 5. All of the 157,887 SARs at a grant price of $1.32 and 72,917 of the SARs at a grant price of $1.38 were vested on the date of the grant, being 4 April 2013. The remaining 218,750 SARs were vested in three equal instalments on 1 July 2013, 1 July 2014 and 1 July 2015 in accordance with the terms of the Hibernia LTI Plan as the Appellant remained employed.
>
> 6. On 31 July 2016 the Appellant ceased his employment with HAUKL.
>
> 7. The Appellant became non-resident in the UK on 1 August 2016.
>
> 8. On 9 January 2017 the Appellant received notice that Hibernia NSG (the successor parent company of HAUKL registered and incorporated in Ireland)

had been sold to GTT Communications Inc, which constituted a sale for the purposes of the Hibernia LTI Plan and the SAR Agreement.

9. As the sale occurred within 24 months of the Appellant leaving his employment, this resulted in a payment of cash equal to the amount by which the then current Fair Market Value of the Shares, to which the vested SARs related, exceeded the Grant Price.

10. As a result, the Appellant received a payment in the sum of £1,236,956 from HAUKL (the "Payment"). The Payment was processed through the Employer's payroll on 13 January 2017 and was subjected to deductions of £549,679.26 PAYE and £26,405.08 Class 1 Primary (Employee's) NICs at source.

11. In his self-assessment tax return for the year 2016/17, the Appellant claimed the split-year treatment (within the meaning of Part 3 (case 3, para 46) to Schedule 45 of the Finance Act 2013[1]) applied in respect of 2016/17. He recorded the Payment as both (1) "Tips and other payments not on your P60" on the employment page and (2) "Foreign earnings not taxable in the UK" on the additional information page. This resulted in a repayment of tax in respect of the tax deducted at source by HAUKL on 22 May 2017.

12. On 9 March 2018 HMRC opened an enquiry into the Appellant's 2016/17 tax return under s.9A Taxes Management Act ("TMA") 1970. Following the enquiry, HMRC issued a closure notice, amending the tax return on the basis that the Payment originally claimed as foreign earnings not taxable in the UK was, in their opinion, subject to UK income tax. An assessment was issued under s.28A TMA 1970 for the additional tax, bringing the total income tax owed to £504,109.25."

RELEVANT LEGISLATION

5. Part 2 Income Tax (Earnings and Pensions) Act 2003 ("ITEPA 2003") imposes a charge to income tax on "employment income", which is defined by s7(2)(a) as including "earnings within Chapter 1 of Part 3". That definition is set out in s62:

"**62 Earnings**

(1) This section explains what is meant by "earnings" in the employment income Parts.

(2) In those Parts "earnings", in relation to an employment, means –

(a) any salary, wages or fee,

(b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or

(c) anything else that constitutes an emolument of the employment.

(3) For the purposes of subsection (2) "money's worth" means something that is –

(a) of direct monetary value to the employee, or

(b) capable of being converted into money or something of direct monetary value to the employee.

(4) Subsection (1) does not affect the operation of statutory provisions that provide for amounts to be treated as earnings (and see section 721(7))."

[1] SOAF[11] incorrectly referred to this as Finance Act 2015.

6. Chapter 4 of Part 2 of ITEPA 2003 then deals with the taxable earnings of UK resident employees:

> **"Taxable earnings**
>
> **14 Taxable earnings under this Chapter: introduction**
>
> (1) This Chapter sets out for the purposes of this Part what are taxable earnings from an employment in a tax year in cases where section 15 (earnings for year when employee UK resident) applies to general earnings for a tax year.
>
> (2) In this Chapter –
>
> (a) sections 16 and 17 deal with the year for which general earnings are earned, and
>
> (b) sections 18 and 19 deal with the time when general earnings are received.
>
> (3) In the employment income Parts any reference to the charging provisions of this Chapter is a reference to section 15.
>
> **UK resident employees**
>
> **15 Earnings for year when employee UK resident**
>
> (1) This section applies to general earnings for a tax year for which the employee is UK resident except that, in the case of a split year, it does not apply to any part of those earnings that is excluded.
>
> (1A) General earnings are "excluded" if they –
>
> (a) are attributable to the overseas part of the split year, and
>
> (b) are neither –
>
> (i) general earnings in respect of duties performed in the United Kingdom, nor
>
> (ii) general earnings from overseas Crown employment subject to United Kingdom tax.
>
> (2) The full amount of any general earnings within subsection (1) which are received in a tax year is an amount of "taxable earnings" from the employment in that year.
>
> (3) Subsection (2) applies whether or not the employment is held when the earnings are received.
>
> (4) Any attribution required for the purposes of subsection (1A)(a) is to be done on a just and reasonable basis.
>
> (5) The following provisions of Chapter 5 of this Part apply for the purposes of subsection (1A)(b) as for the purposes of section 27(2)—
>
> (a) section 28 (which defines "general earnings from overseas Crown employment subject to United Kingdom tax"), . . .
>
> (b) sections 38 to 41 (which contain rules for determining the place of performance of duties of employment), and
>
> (c) section 41ZA (which is about determining the extent to which general earnings are in respect of United Kingdom duties).
>
> (6) Subject to any provision made in an order under section 28(5) for the purposes of subsection (1A)(b), provisions made in an order under that section

for the purposes of section 27(2) apply for the purposes of subsection (1A)(b) too.

Year for which general earnings are earned

16 Meaning of earnings "for" a tax year

(1) This section applies for determining whether general earnings are general earnings "for" a particular tax year for the purposes of this Chapter.

(2) General earnings that are earned in, or otherwise in respect of, a particular period are to be regarded as general earnings for that period.

(3) If that period consists of the whole or part of a single tax year, the earnings are to be regarded as general earnings "for" that tax year.

(4) If that period consists of the whole or parts of two or more tax years, the part of the earnings that is to be regarded as general earnings "for" each of those tax years is to be determined on a just and reasonable apportionment.

(5) This section does not apply to any amount which is required by a provision of Part 3 to be treated as earnings for a particular tax year.

17 Treatment of earnings for year in which employment not held

(1) This section applies for the purposes of this Chapter in a case where general earnings from an employment would otherwise fall to be regarded as general earnings for a tax year in which the employee does not hold the employment.

(2) If that year falls before the first tax year in which the employment is held, the earnings are to be treated as general earnings for that first tax year.

(3) If that year falls after the last tax year in which the employment was held, the earnings are to be treated as general earnings for that last tax year.

(4) This section does not apply in connection with determining the year for which amounts are to be treated as earnings under Chapters 2 to [10] of Part 3 (the benefits code).

When general earnings are received

18 Receipt of money earnings

(1) General earnings consisting of money are to be treated for the purposes of this Chapter as received at the earliest of the following times –

Rule 1

The time when payment is made of or on account of the earnings.

Rule 2

The time when a person becomes entitled to payment of or on account of the earnings…

...

(5) Where this section applies –

(a) to a payment on account of general earnings, or

(b) to sums on account of general earnings,

it so applies for the purpose of determining the time when an amount of general earnings corresponding to the amount of that payment or those sums is to be treated as received for the purposes of this Chapter."

EVIDENCE AND ISSUES

7. We had the benefit of the parties' skeleton arguments, a hearing bundle (which included the SOAF as well as correspondence between the parties and documentation in relation to the Hibernia LTI Plan and the SAR Agreement) and an authorities' bundle. There were no witness statements, and no witnesses at the hearing.

8. Mr Saunders appealed against the closure notice on the following grounds:

(1) HMRC wrongly concluded that the Payment was a payment of income;

(2) HMRC wrongly concluded that the Payment was emoluments of Mr Saunders' employment; and

(3) HMRC wrongly concluded that the Payment was earnings in a year when he was resident in the UK.

9. At the hearing, Mr Firth confirmed that Mr Saunders no longer pursued a separate ground of appeal in relation to the application of the double tax treaty between the UK and Thailand.

10. Mr Saunders' positive case (based on the skeleton argument and oral submissions) can be summarised as follows:

(1) The SARs are valuable contractual or property rights. The reward for employment was delivered at the time of grant and was taxable at that time to the extent of any value immediately conferred. Thereafter, the SARs were Mr Saunders' rights or property, and the Payment arose from his rights or property, and not as reward for the performance of his employment duties to which the Payment bore no ongoing connection. The position is on all fours with the decision of the House of Lords in *Abbott v Philbin (Inspector of Taxes)* [1961] AC 352. Mr Firth drew an analogy with an employee being given a lottery ticket by his employer – the value of that ticket was general earnings at the time it was given to the employee, but thereafter, if it was a winning ticket, the payout would arise from the lottery ticket, not from the employment.

(2) Even if the Payment is earnings, it was earned in the non-resident part of the split year. There is no just and reasonable apportionment over the earlier (UK resident) years. The only way to apportion the Payment on a just and reasonable basis would be to allocate it all to the point of disposal when it crystalised in quantum and liability, at which point Mr Saunders was in the non-resident part of a split year and the Payment was excluded income. There is nothing about the facts relating to the Payment to treat it as "earned" in or in respect of any earlier period.

11. HMRC's case was that:

(1) the Payment is general earnings within the meaning of s62 ITEPA 2003;

(2) the earnings were earned in a period during which Mr Saunders was resident in the UK (s16 ITEPA 2003); and

(3) the Payment is taxable in the year in which it was received (s18 ITEPA 2003).

12. The burden of proof is upon Mr Saunders to show that the self-assessment (as amended) is excessive (s50(6) TMA). The standard of proof is the balance of probabilities.

ADDITIONAL FINDINGS OF FACT

13. We make the following findings of fact in addition to those agreed between the parties in the SOAF. These primarily relate to the terms of the Hibernia LTI Plan and the SAR Agreement, and were not in dispute between the parties.

14. The purpose of the Hibernia LTI Plan is set out as follows:

"Section 1: Introduction

"…The purpose of the plan is to promote the long-term success of the Company [Hibernia Group ehf] and its subsidiaries [including the Employer] and the creation of shareholder value by offering selected Employees, consultants and Directors an opportunity to share in such long-term success.

The Plan seeks to achieve this purpose by providing for discretionary long-term incentive Awards in the form of Stock Appreciation Rights and/or Phantom Shares."

15. The Hibernia LTI Plan then sets out provisions in relation to SARs:

"Section 6: Terms and Conditions of Stock Appreciation Rights

(a) Stock Appreciation Rights Agreement. Each Grant of a SAR shall be evidenced and governed exclusively by a Stock Appreciation Rights Agreement between the Participant and the Company

…

(d) Term, Vesting, Accelerated Vesting.

(i) The Stock Appreciation Rights Agreement shall specify the term of the SAR, which may be up to fifteen (15) years from the Grant date, but which shall be subject to the two (2) year period set forth in Section 4(e) and paragraph (e)(ii) of Section 6 should the Participant leave or no longer provide his services to the Company or any Hibernia Subsidiary

…

(iii) All unvested SARs held by a Participant shall vest in the event of (A) Sale or (B) should the Participant be terminated (other than for Cause) within 24 months following a Change of Control."

16. Section 2(gg) defines a "SAR" and provides that the amount of a SAR Award shall be the difference between the Fair Market Value of a Share at the time a SAR Award is settled, minus the Grant Price per Share of the Award, times the number of Shares included in the settled SAR Award. Those terms are then defined:

(1) at 2(n), "Fair Market Value" means the fair market value of the Shares as determined by the Board at the relevant time; and

(2) at 2(q), "Grant Price" means the base value of a SAR Award from which the appreciation amount of the SAR shall be determined. This shall be determined by the Board at the time a SAR Award is made.

17. Section 4(e) provides for what happens on termination of service. For a good leaver (ie death, disability, termination without Cause or resigns for Good Reason), unvested SARs for the year of termination shall accelerate. For a bad leaver (ie termination for Cause or resigns without Good Reason), all unvested SARs terminate and are forfeited immediately. A terminated Participant shall become entitled to vested SARs only if a Closing Date happens within two years after the date of termination.

18. Section 6(e) also contains provisions in relation to forfeiture of SARs. After termination of employment (other than, eg, for Cause), a Participant retains the right to become eligible for vested SARs for two years after the termination date, but any unvested SARs are immediately forfeited. Vested SARs are forfeited if there is no Closing Date within two years of the termination date, Closing Date being the date on which a Liquidity Event or Sale has been completed and the Company has received the consideration. Where the employment is terminated for Cause, vested and unvested SARs are forfeited upon termination.

19. Section 10(a) states that any award granted is not intended to be compensation of a continuing or recurring nature or part of a Participant's normal or expected compensation. Section 12(b) states that the Company may terminate the Hibernia LTI Plan at any time, but termination does not impair the rights or obligations of any Participant under any Award previously granted without the Participant's consent.

20. The SAR Agreement was issued to Mr Saunders on 4 April 2013, and that sets out the number of SARs granted to him, the grant price, provisions in relation to vesting, the expiration date of 3 April 2023 (at which time they would expire with, we infer, nil value) and further terms.

21. Section 2 dealt with vesting of the SARs issued to Mr Saunders, as set out at SOAF[5]. All of his SARs had vested prior to the termination of his employment. Section 2 records that prior to the time that the SARs are settled, the holder has no rights other than those of a general creditor of the Company and the SARs remain subject to a substantial risk of forfeiture.

22. Sections 3 and 5 then addressed the position on termination and settlement:

> "3. Termination of Service. In the event of the termination of your Service by the Company or a Hibernia Subsidiary, the following rules shall govern the vesting and exercisability of outstanding SARs: (i) if your Service is terminated due to death, Disability, without Cause or you resign for Good Reason, then the portion of unvested SARs with respect to the year in which the termination occurs shall accelerate and become vested; or (ii) if your Service is terminated for Cause or you resign without Good Reason, then the portion of unvested SARs held by you shall terminate and be forfeited immediately without consideration. Vested SARs held by you shall only be exercisable if a Closing Date occurs within two (2) years following the date of your termination…
>
> …
>
> 5. Settlement of SARs. In the case of a Sale, all vested SARs shall be settled in cash (or other consideration received by the Company Shareholders) on the Closing Date…
>
> The Company shall pay to you with respect to and in cancellation of vested SARs, an amount of cash (or other consideration), in the aggregate, equal to the amount by which the then current Fair Market Value of the Shares subject to vested SARs exceeds the Grant Price."

23. Section 8 set out that the SARs may not be transferred other than by the laws of descent and distribution, but they may be assigned during a Participant's lifetime to specified persons or entities in connection with an estate plan or domestic relations order.

24. Following the cessation of Mr Saunders' employment with HAUKL, he was engaged by them as a consultant in a self-employed capacity. This engagement was after Mr Saunders became non-resident, and any duties he performed as a consultant were performed outside of the UK.

DISCUSSION

25. The Payment was made to Mr Saunders after his employment by HAUKL had ceased, and after he had become non-UK resident. It was common ground that the SARs had been granted to him in connection with his employment. The question is how the provisions of Chapter 4 of Part 2 of ITEPA 2003 apply to the Payment.

26. We have summarised the parties' submissions above in very brief terms to set out how they each approached the analysis in the present case. We have taken account of their detailed

written and oral submissions in reaching our conclusion, albeit we have not considered it necessary to refer herein to each of them, or to all of the authorities to which we were referred.

27. Warren J set out a helpful explanation of the operation of the charging provisions in *Martin v HMRC* [2014] UKUT 429 (TCC), which we gratefully adopt:

> "[15] Tax is imposed under the charging provision (s 9 ITEPA). So far as concerns general earnings for a particular year, the amount on which tax is charged is the 'net taxable earnings from an employment in that year'. The net taxable earnings are defined in s 11 (to which I will come in more detail later); one component of the definition is the taxpayer's 'taxable earnings'. Taxable earnings are defined in s 10(1) which states that they are to be determined in accordance with Chs 4 and 5 of Pt 2. For present purposes, it is necessary to refer only to s 62, the relevant parts of which are set out in Annex 2 below. As I have noted at [8], above, the Signing Bonus was either an 'emolument of employment' under s 62(2)(c) ITEPA or, at least in part, fell to be treated as earnings under s 225 (payment for restrictive undertakings).
>
> [16] Section 15 is concerned with tax years when a taxpayer is resident, ordinarily resident and domiciled in the UK. Mr Martin was so resident, ordinarily resident and domiciled. Section 15(3) as it stood for the tax years relevant to the present appeal is also set out in Annex 2 below. Where a person receives an amount of 'earnings' in a tax year, it is taxable in the year of receipt (a) whether the earnings are 'for' that year or 'for' some other tax year and (b) whether or not the employment is held at the time when the earnings are received. Paragraph (b) recognises that an amount might be received when an employment is not held, for instance a payment received before the employment is taken up or after it has come to an end.
>
> [17] All income must have a source to be taxable; accordingly, employment income must be earned in a year in which the employment is held; and, as already noted, income must be received before it is taxable. These two aspects (earnings and receipt) are dealt within in ss 16 to 19. These four sections are introduced by s 14(2): ss 16 and 17 are stated to 'deal with the year for which general income is earned' and ss 18 and 19 are stated to 'deal with the time when general earnings are received'.
>
> [18] Sections 16 and 17 are also set out Annex 2 below. The foundation is set out in s 16(2): general earnings earned in, or otherwise in respect of, a particular period are to be regarded as general earnings for that period. And so (see s 16(3)) if that period consists of the whole or part of a single tax year, the general earnings are regarded as being 'for' that tax year and (see s 16 (4)) if that period consists of the whole or parts of two or more tax years, there is to be a just and reasonable apportionment in order to establish for which years the general income is to be regarded as 'for'.
>
> [19] Section 17 deals with cases where general earnings would otherwise fall to be regarded as being 'for' a tax year in which the employee does not hold the office. It operates by treating the earnings as being 'for' a different year in which the employment did subsist. This reflects the source doctrine mentioned at [17], above."

28. We agree with HMRC that the Payment, and not simply the SARs, was earnings from Mr Saunders' employment within s62 ITEPA 2003 (and not from "something else"), was earned in, or otherwise in respect of, the period 4 April 2013 to 31 July 2016 and was general earnings for that period and not excluded by s15(1A) ITEPA 2003. Our reasons for reaching these conclusions are set out below.

29. For completeness, we record that we have made findings in relation to the consultancy arrangement which was in place after the termination of Mr Saunders' employment. The existence of this arrangement does not change the source of the SARs or the Payment, or the period for which the Payment was earned, and no submissions were made by Mr Firth to the contrary.

Whether Payment was earnings from employment

30. We were taken to various authorities by Ms Hicks and Mr Firth in relation to the approach to be taken to assessing whether the Payment was derived from being or becoming an employee rather than "something else", including *Shilton v Wilmshurst* [1991] 1 AC684 and *Hamblett v Godfrey* [1987] 1 WLR 357.

31. It was common ground that the SARs had been granted to Mr Saunders and vested in connection with his employment. We consider it helpful at the outset to record the features which underpinned this position. The SARs were granted to employees and incentivised employees to remain employed. The 218,750 unvested SARs held by Mr Saunders would not have vested if he had not remained employed on the three vesting dates (of 1 July 2013, 1 July 2014 and 1 July 2015). He would have forfeited the vested SARs if his employment had terminated for Cause, and they would have been forfeited if there was no Closing Date within two years of termination of his employment otherwise.

32. It was the SARs which set out Mr Saunders' (conditional) entitlement to receive the Payment. Ms Hicks submitted that the Payment was derived from Mr Saunders' employment relationship with HAUKL (and constituted earnings from employment). She submitted that the employment relationship was central to the right to the Payment – for a good leaver, unvested SARs would vest but the former employee ran the risk of no Closing Date occurring within two years, whereas a bad leaver forfeited all unvested and vested SARs upon termination of employment.

33. Mr Firth's submissions to the contrary were based on his submission that the Payment arose from "something else" other than employment, in this case the SARs, which he submitted were separate contractual or property rights of Mr Saunders. Mr Firth relied in particular on the decision of the House of Lords in *Abbott v Philbin*, emphasising that the ratio of the majority remained good law (save to the extent it had been reversed by specific statutory provisions) and had been applied by the Supreme Court in *UBS AG v HMRC; DB Group Services (UK) Ltd v HMRC* [2016] UKSC 13 in the context of what were found to be unrestricted shares issued to employees.

34. We consider those authorities and the reasoning therein below.

35. In *Abbott v Philbin* Mr Abbott was the director of a company who received stock options from his employer giving him the right to subscribe for stock in the employer company. The price of the option awarded to him was £20 (which he paid, completing the required application form). The option was non-transferable and expired after 10 years or on the earlier death or retirement of the taxpayer. If exercised, the shares acquired would be freely transferable. The share price increased between the grant (in 1954/55) and the exercise (in 1955/56) of the option and HMRC sought to tax the difference between the option price and the value of the shares on exercise as an emolument of his employment in 1955/56.

36. Mr Abbott did not dispute that he had derived a perquisite from his employment, but he contended that the perquisite was the option acquired by him in 1954/55 and that he was assessable in that year for the value of the option over the cost of acquisition, but not assessable in 1955/56 on the basis of the benefit obtained by him from exercise of the option.

37. This was a majority decision of the House of Lords, finding in favour of Mr Abbott. The majority (Viscount Simonds, Lord Radcliffe and Lord Reid) gave separate speeches.

38. Viscount Simonds drew attention to the fact that the Crown's position was based on the grant of the option not being a perquisite or profit in 1954/55, and that the Crown did not contend that if the grant was itself a perquisite or profit then the subsequent exercise of the option was a second. He said (at pg 365):

> "My Lords, I cannot entertain any doubt that, when the company granted the option to the appellant, he acquired something of potential value. I do not think that it matters whether it falls into the category of proprietary or contractual right, or into some dim twilight that divides those juristic conceptions. … [T]he chosen words "perquisite or profit whatsoever" are as wide and general as they well could be. I can concede no relevant limitation of their meaning except in the oft cited words of Lord Watson in Tennant v. Smith that they denote "something acquired which the acquirer becomes possessed of and can dispose of to his advantage - in other words, money - or that which can be turned to pecuniary account.
>
> How, then, can it be said that an option to take up shares at a certain price is not a valuable or at least a potentially valuable right? Its genesis is in the desire of the company to give a benefit to its employees and at the same time, no doubt, to enhance their interest in its prosperity".

39. The option could be turned to pecuniary account, even though it was not transferable. In Viscount Simonds' speech, this was sufficient for the Crown's case to fail (given that their argument depended on the grantee not acquiring a perquisite at the date of grant). But he went on to consider "other grave difficulties" with the Crown's position, saying he did not find it easy to say that the increased difference between the option price and the market price in 1956 (or later years) in any sense derived from the office. It will be due to numerous factors.

40. Lord Reid similarly referred to the Crown's position that the taxpayer received no perquisite upon grant in 1954. He agreed that the question was whether the option was a right of a kind which could be turned to pecuniary account, stating that "the test must be the nature of the right and not whether this particular option could readily have been turned to pecuniary account". This is a question of fact and there was no finding about it; he was not prepared to assume it could not have been, referring to ways the taxpayer could have monetised the option. Lord Reid then also considered "another difficulty" for the Crown, namely that if the option is not the perquisite, and there is no perquisite until shares are issued, which may be many years later, in what sense would the shares be a perquisite for the year when they were issued; there would be no relation between the service during that year and the giving of the option many years earlier or the exercise of the option during the later year. He said he would not express a concluded opinion on this point.

41. Lord Radcliffe also set out that what taxable receipt there is lies in the acquisition of the option, and it was the monetary value when received that represents the perquisite or profit of the office. The option, when paid for, was thereafter a contractual right enforceable against the company at any time during the next 10 years so long as the holder paid the stipulated price and remained in its service. It was not incapable of being turned into money or of being turned to pecuniary account. The option enabled the holder, at any time, at his choice, to obtain shares from the company. In his opinion:

> "…the conferring of a right of this kind as an incident of service is a profit or perquisite which is taxable as such in the year of receipt, so long as the right itself can fairly be given a monetary value, and it is no more relevant for this purpose whether the option is exercised or not in that year than it would be if

> the advantage received were in the form of some tangible form of commercial property"

42. Lord Radcliffe then continued that the claim to tax the profit in 1955/56 would fail on its own terms; the advantage on exercise was not a perquisite or profit from the office during the year of assessment, it was an advantage which accrued to the appellant as the holder of a legal right which he had obtained in an earlier year and which he exercised as an option holder.

43. Mr Firth relied on this decision and submitted that at the time of the grant of the SARs in 2013, Mr Saunders had received, as a benefit from his employment, valuable contractual rights that could be turned to pecuniary account, either then or at some time in the future. The majority in *Abbott v Philbin* had expressly considered and agreed that this applied where rights granted were not assignable – such rights could be turned to account if someone would pay something for the agreement of the holder to collect the benefit on exercise and pay it on to them. Here, Mr Saunders could have assigned the SARs in certain circumstances, and in any event could clearly have entered into a contract to hold the rights for someone else for consideration, and pay over the Payment to that person if and when it was paid out. The grant, or (at the latest) vesting, of the SARs was the only taxable event that was a benefit from his employment.

44. Mr Firth referred us to the decision of the Supreme Court in *UBS* and drew our attention to the background to the statutory regime in Part 7, the legislative reversal of *Abbott v Philbin*, but also its residual application where Part 7 does not apply.

45. *UBS* addressed the question whether shares which had been issued were "restricted securities" (as defined by s423(1)(2) ITEPA 2003) within the employment-related securities regime such that they were exempt from income tax. Lord Reed (with whom Lord Neuberger, Lord Mance, Lord Carnwath and Lord Hodge agreed) considered the background to the relevant legislation by reference to previous law and its context within Part 7 ITEPA 2003:

> (1) Under ordinary principles, where an employee receives shares as part of his remuneration, he is liable to income tax on the value of the shares, less any consideration which he may have given for them (*Weight v Salmon* (1935) 19 TC 174) (at [4]).
>
> (2) The position where an employee is granted a conditional share option was considered by the House of Lords in *Abbott v Philbin*. There it was held that income tax was chargeable on the realisable monetary value of the option at the date of its acquisition, rather than on the value realised when it was subsequently exercised (at [4]).
>
> (3) The decision in *Abbott v Philbin* was reversed (initially by s25 Finance Act 1966) which removed any charge to income tax on the grant of employee share options, and instead imposed a charge on the gain realised when the option was exercised, assigned or released. Section 78 Finance Act 1972 ("FA 1972") subsequently conferred an exemption from charge in relation to approved share option schemes (at [5]).
>
> (4) These provisions only applied to share option schemes, and not to share incentive schemes (involving the award of shares to which restrictions might be attached). Until 1998, the revenue took the view that no charge to income tax arose when shares of that type were acquired, and there was not, until FA 1972, a specific charge to income tax when the restrictions attached to the shares were lifted (at [6]).
>
> (5) Section 79 FA 1972 imposed a charge to income tax on the value of employment-related shares (less any consideration given) upon the earlier of specified events. Approved share option schemes were excluded from the scope of the charge (at [7]).

(6) By 1998 the revenue had received legal advice in relation to remuneration provided in the form of shares subject to forfeiture that the *Abbott v Philbin* principle applied, so that a charge to tax arose at the time when the shares were first awarded (on a value reduced by the risk of forfeiture) (at [8]).

(7) There was a change in law, namely the introduction of s140A to 140C Income and Corporation Taxes Act 1988, which were later re-enacted as Chapter 2 of ITEPA 2003, which was itself replaced a few months later with a more complex Chapter 2 within an amended Part 7 ITEPA 2003 (at [10] to [11]).

(8) Lord Reed cited the judgment of Lord Walker in *Gray's Timber Products Ltd v HMRC* [2010] 1 WLR 497 where Lord Walker summarised the principle in *Abbott* at [5] as that if employee benefits are convertible they should be taxed when first acquired, citing Lord Radcliffe's reference to the principle of taxing an employee as soon as he received a right or opportunity which might or might not prove valuable to him (at [12]).

(9) Part 7 contains special rules about cases where securities, interests in securities or securities options are acquired in connection with an employment. Chapter 2 creates a special regime for employment-related securities if they are "restricted securities" at the time of their acquisition. The banks argued that the shares in question in these appeals are "restricted securities" (at [13] to [16]).

(10) Section 425(2) confers an exemption from income tax in respect of the acquisition of employment-related securities where they are restricted securities by virtue of section 423(2) at the time of the acquisition, and will cease to be restricted securities by virtue of that provision within the next five years. The exemption from tax is optional: the employer and employee may elect that it is not to apply, in which case a charge to income tax will arise in accordance with *Abbott v Philbin* (at [18]).

(11) Having considered the schemes which were implemented, the decisions of the courts below, the *Ramsay* approach, *Scottish Provident*, purposive interpretation and submissions in those appeals, Lord Reed concluded that the relevant restrictions were limited to those having a business or commercial purpose, and not to commercially irrelevant conditions whose only purpose is the obtaining of the exemption (at [85]).

(12) The shares were not "restricted securities" (at [90]) and the recipients fell to be taxed in respect of their receipt in accordance with ordinary principles. Lord Reed applied the principles laid down in *Abbott v Philbin* that the value of the shares had to be assessed as at the date of their acquisition, taking account of the conditions attached (at [94]).

46. Ms Hicks accepted that the decision in *Abbott v Philbin* remains good law, save to the extent that it has been expressly reversed by statute. The dispute was as to its scope. Ms Hicks' submissions included that Mr Abbott had acquired a distinct, separate asset, the option, which he had paid for and which was extant for 10 years independent of the employer's business, with, she submitted, no further link to continued employment or the circumstances of leaving. By contrast, Mr Saunders simply had a contingent right to a future payment, based on the Fair Market Value of the Shares, which was subject to the contingency of a Sale or Liquidity Event and which would only be paid out if his rights vested and he left as a good leaver. This was, Ms Hicks submitted, in line with the facts in *Edwards v Roberts* [1935] 19 TC 618. Ms Hicks also submitted that unless and until the conditions inherent in the SARs were satisfied (ie continued employment or good leaver and the fact of a Sale or Liquidity Event), the SARs had no value that could be realised.

47. Ms Hicks referred us to the decision of the Supreme Court in *RFC 2012 plc v Advocate General for Scotland* [2017] UKSC 45, in which Lord Hodge JSC (with whom the other members of the Supreme Court agreed) set out at [41] the general rule that the charge to tax on employment income extends to money that the employee is entitled to have paid as his or her remuneration, whether it is paid to the employee or a third party. Lord Hodge went on to state that not every payment by an employer to a third party falls within the tax charge. Circumstances falling outside the general rule were said to include three situations, the third of which, and that on which Ms Hicks relied, was an arrangement by which the employer's payment does not give the intended recipient an immediate vested beneficial interest but only a contingent interest. Here, the taxable earnings are not paid as remuneration until the occurrence of the contingency. This was said (at [47]) to be illustrated by *Edwards v Roberts*. An employing company entered into an employment contract to give an employee, in addition to his salary, an interest in a conditional fund, into which it would make annual payments from its profits, as an incentive for him to advance the company's interests. The employee was entitled to receive the annual income from the fund but had no right to receive any of the capital of the fund other than that which had been held in the fund for five years or more. The contract provided that he would receive the whole fund if he died while still employed by the company or on termination of his employment by the company in specified circumstances. But the contract also provided that the employee would cease to have any right in the conditional fund in circumstances which included his dismissal for misconduct. The trustees of the fund handed over to the employee the investments in the fund when he later resigned with the consent of the company. The employee argued that the sums which the company had paid into the conditional fund formed part of his emoluments in each of the years in which they were paid into the fund. But the Court of Appeal (Lord Hanworth MR, Romer and Maugham LJJ) held that those sums did not constitute his emoluments in those years because he had only a conditional interest in them; instead, the value of the investments transferred to him after his resignation were his emoluments in the tax year in which they were transferred to him. The payments in that year reflected his status as an employee at the time when the contingency was fulfilled.

48. In reaching our decision in the present case, we focus on the ratio of the majority in *Abbott v Philbin* and the scope of that decision. The majority decision was that there was only one taxable event in respect of the grant of the option to Mr Abbott. As the option was "something" that could be turned into money, it was the grant itself which was the perquisite from employment and not the subsequent exercise. That was the ratio of the decision. Viscount Simonds and Lord Reid did then consider *obiter* that there was a further difficulty for the Crown, as to whether, if the taxable event only occurred when the option was exercised, the shares were then a perquisite for the year they were issued, questioning the relationship between a taxpayer's service in that year and the exercise of the option several years later. Lord Radcliffe was the only member of the majority who would have found that the Crown's case failed on these terms.

49. Mr Firth and Ms Hicks summarised the facts of *Abbott v Philbin* differently in one potentially relevant respect. Ms Hicks said there had been no link to continued employment, whereas Mr Firth said that it was a condition that Mr Abbott remained employed. We have carefully reviewed the case report. The case stated refers only to the option expiring after 10 years or the earlier death or retirement of the taxpayer – it is silent as to termination of employment otherwise. We might have taken this to mean that the option would remain exercisable if Mr Abbott left the employment for other reasons. However, we consider it clear from the speeches that their Lordships construed this differently. Counsel for the Crown's submissions had referred to there being a requirement that the holder was still in employment, and whilst Viscount Simonds did not extend his summary of the terms beyond the language

used in the case stated, Lord Reid, Lord Radcliffe and Lord Keith (in the minority) referred expressly to the option being exercisable so long as Mr Abbott was in the company's service. So, to the extent we consider there was ambiguity from the case stated, we proceed on the basis that the option would terminate or lapse if Mr Abbott left his employment for whatever reason (ie death, retirement or otherwise). We have not, however, needed to place any weight on this aspect of the decision when reaching our conclusion.

50. We recognise that in *UBS* Lord Reed had referred to *Abbott v Philbin* as considering the position where an employee is granted a conditional share option (at [4]). However, we respectfully consider that this abbreviated reference preceded a summary of the facts in that case and was set out in the context that the decision on the facts itself had been reversed by legislation and it was the scope of that legislation and the meaning of restricted securities which was being considered in *UBS*.

51. Here, the SARs were not securities options, securities or interests in securities; there was no suggestion that Part 7 ITEPA 2003 applied to them. They are simple contractual, contingent payment rights. We recognise that Viscount Simonds had said it did not matter whether the rights granted were proprietary or contractual or somewhere in between, but that reasoning was not part of the ratio of the majority; Lord Radcliffe had referred to the option as a contractual right, but that was in the context of referring to it as being enforceable by the holder against the company – his reasoning focused on Mr Abbott holding an option to acquire shares and the treatment of the receipt of a right of that kind, comparing it to the situation where the advantage received was a tangible form of commercial property. On the facts in *Abbott v Philbin*, Mr Abbott had purchased an option to acquire shares, which was capable of exercise by him in accordance with its terms. We do not read that decision as meaning that any deferred payment rights granted to, or held by, employees should be treated as separate from any subsequent payment such that they are taxable upon grant or award. We consider that such an approach, treating all rights to a payment as potentially capable of falling within *Abbott v Philbin* (on the basis that, prior to any payment being made, the employee or former employee will always have a right to such payment, whether for a matter of days or years), focuses only on pecuniary value and overlooks the "something" (per Viscount Simonds) or the "nature of the right" (per Lord Reid). *Abbott v Philbin* concerned an option which had been purchased by Mr Abbott; *UBS* concerned shares which had been issued to employees. It is for this reason that we do not find Mr Firth's analogy of a lottery ticket being awarded to an employee which then turns out to be a winning ticket in a draw which takes place later to be persuasive. In that scenario, we would accept that the lottery ticket should be treated in the same way as the option had been by the House of Lords.

52. We do not place any weight on Ms Hicks' submission that the value of the SARs could not be realised, either on entry into the SAR Agreement or on vesting as Mr Saunders did not acquire anything of money's worth. There was no evidence of fact or expert evidence as to value relevant to this submission before us, and whilst we consider that there would be considerable difficulties in trying to place a value upon the SARs (as such an exercise would have to take account of the potential Fair Market Value of the Shares, the likelihood of a Sale or Liquidity Event and the risk of Mr Saunders leaving as a bad leaver), we are reluctant to accept that these difficulties mean that the SARs had a value of nil. They had the prospect of paying out a large sum, as indeed happened here.

53. However, whilst Mr Firth submitted that the Payment in the present case was from the SARs and not from the employment, we do not accept on the facts that there was such a separation, or that the grant and vesting of the SARs, or the satisfaction of the conditions set out in the SAR Agreement, were distinct, supervening events which broke the causal relationship with Mr Saunders' former employment. We consider that the entitlement to the

Payment, and its subsequent receipt, arose from Mr Saunders' employment relationship with HAUKL.

54. We have concluded that the Payment was part of the reward for services provided by Mr Saunders. The Hibernia LTI Plan was an incentivisation plan to promote the success of the Company and its subsidiaries – employees were incentivised to remain in employment or leave as good leavers. The value is realised by a payment on the occurrence of a Liquidity Event or Sale, and that value is increased as the performance of the Company improves and the Shares increase in value. The character of the Payment as a reward for services does not change, or cease to be the case, just because the quantum of the Payment or the condition of Sale or Liquidity Event were not directly and specifically linked to the performance by Mr Saunders of his specific duties of employment.

55. The terms of the SAR Agreement, which detailed the grant and vesting of the SARs, contemplated that Mr Saunders might become entitled to receive a payment after his employment had ceased, in circumstances where he was a good leaver and there was a Closing Date within two years. This was part of the overall reward to which he was entitled as part of his employment by HAUKL. It is clear from the authorities, including *Hochstrasser (Inspector of Taxes) v Mayes* [1960] AC 376, that profits from employment can include payments which were a reward for past services (as well as present or future).

56. The Payment was payment of income, notwithstanding that it was paid as a lump sum and on the occurrence of the condition of a Sale occurring. These features do not change the source (Mr Saunders' employment) or nature of the earnings.

Period for which Payment was earned

57. For the reasons set out above, we have concluded that the Payment is earnings and is taxable as employment income. The question is then how Chapter 4 of Part 2 ITEPA 2003 applies. It was common ground that the Payment was received in 2016/17, both in fact and for the purposes of s18. The dispute concerned the application of s15 to s17.

58. Mr Firth's alternative submission was that if the Payment is earnings within s62, s15(1A)(a) should be applied to exclude the earnings from charge as the Payment is attributable to the overseas part of the split year.

59. Section 15 is the relevant charging provision, and ss16 and 17 deal with the year for which general earnings are earned.

60. Section 15(1) provides that the section applies to general earnings for a tax year for which the employee is UK resident, except that, in the case of a split year, it does not apply to any part of those earnings that is excluded. Section 15(1A) then sets out when general earnings are excluded, and this is if earnings are attributable to the overseas part of the split year and are not general earnings in respect of duties performed in the UK. Section 15(2) provides that the full amount of any general earnings within s15(1) which are received in a tax year is an amount of "taxable earnings" from the employment in that year. Section 16 then applies for determining whether general earnings are general earnings "for" a particular tax year, and s16(2) provides that general earnings that are earned in, or otherwise in respect of, a particular period are to be regarded as general earnings for that period. Section 16(4) provides that if the period consists of the whole or parts of two or more tax years, the part of the earnings that is to be regarded as general earnings "for" each of those tax years is to be determined on a just and reasonable apportionment. Section 17 applies where general earnings from an employment would otherwise fall to be regarded as general earnings for a tax year in which the employee does not hold the employment, and s17(3) states that if that year falls after the last tax year in which the

employment was held, the earnings are to be treated as general earnings for that last year. That deeming provision does not apply for the purpose of s15(1A).

61. As re-iterated by Warren J in *Martin*, all income must have a source to be taxable, and this means that employment income must be earned in a year in which the employment is held. Mr Firth submitted that the making of the Payment, its timing and its amount were all dependant on extraneous events, outside of Mr Saunders' control as an employee or former employee – the making of the Payment was triggered by the Sale, and the quantum was calculated by reference to the Fair Market Value of the Shares at the time the award was paid out rather than being directly attributable to the work of Mr Saunders in any earlier years. The Payment was, he submitted, a contingent and exceptional bonus, only "earned" at the time of the Sale, which was in the overseas part of a split year. Had the Sale not occurred within two years of the end of his employment, no payment would have been made.

62. We do not accept these submissions. The SAR Agreement contemplated that a single payment would be made, and that it may be made after the termination of employment, setting out the conditions for payment and that the vested SARs would be forfeited if the conditions were not met. We consider that focusing only on the trigger event, the Sale, fails to take account of the full picture in the present instance. In particular,

(1) the express purpose of the Hibernia LTI Plan and the SAR Agreement was to incentivise Mr Saunders' performance from the date of grant and whilst he was employed by HAUKL, which was from 4 April 2013 to 31 July 2016, such that he would contribute to the performance of the Company; and

(2) the SAR Agreement not only incentivised his continued employment by HAUKL, as the unvested SARs were to vest if he continued to be employed on the vesting dates, but also the provisions relating to termination of employment meant he was incentivised to leave as a good leaver.

63. We consider that in the light of all of the facts and circumstances, the Payment was part of Mr Saunders' reward for his services from 4 April 2013 to 31 July 2016, and comprised general earnings for that period.

64. Mr Saunders was UK resident in the tax years 2013/14, 2014/15 and 2015/16. 2016/17 was a split year, and he received the Payment in the overseas part of that year. However, we do not accept that Mr Firth's submission that the Payment was excluded by s15(1A) as earned in the overseas part of the split year. The Payment was earned by Mr Saunders for his services performed whilst he was resident in the UK and in respect of duties performed by him in the UK.

65. We have therefore concluded that the entirety of the Payment is general earnings for tax years for which Mr Saunders was UK resident. In accordance with s15(2), the full amount of the Payment is taxable earnings from the employment in the year in which it was received, ie 2016/17. It does not matter for this purpose that the employment was not held when the Payment was received (s15(3)).

DISPOSITION

66. The appeal is dismissed.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

67. 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.

JEANETTE ZAMAN
TRIBUNAL JUDGE

Release date: 02nd APRIL 2024