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Georgia Hicks successful in Upper Tribunal decision about the scope of the Abbott v Philbin principle: Saunders v HMRC [2025]

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Overview

Abbott v Philbin established that receipt of a perquisite from employment should be taxed when it is capable of being turned to pecuniary account. The decision was reversed in respect of shares, options and securities in what is now Chapter 5 of Part 7 of the Income Tax (Earnings and Pensions) Act 2003. But Abbott v Philbin remains good law in respect of a class of rights that is not rights to shares, options and securities. However, the scope of the application of this principle has not been directly tested until now: this was the first case to consider the "type and nature of rights which can bring the Abbott v Philbin approach into play, and whether there are any limitations on them" (UT 57).

Facts

The taxpayer worked for Hibernia Atlantic UK Ltd, in the UK, from April 2008 to 31 July 2016. During the course of his employment, on 14 March 2013, his employer adopted a Long-Term Incentive Plan, the stated aim of which was to "promote the long-term success of the Company…by offering selected Employees, consultants and Directors an opportunity to share in such long-term success." It was to do this by "providing for discretionary long-term incentive Awards in the form of Stock Appreciation Rights and/or Phantom Shares" (UT 5).

In due course, on 4 April 2013, the Appellant was awarded Stock Appreciation Rights ("SARs") under a SAR Agreement. Some were vested at the date of grant at a set grant price. The others were to vest in three equal instalments on 1 July 2013, 1 July 2014, and 1 July 2015 (UT 3(5)).

On 1 August 2016 he moved to Thailand and thus became non-resident in the UK (UT 3(6)). On 9 January 2017 the Appellant received notice that the Company had been sold, which constituted a 'Sale' for the purposes of the SAR Agreement (UT 3(8)). As the sale occurred within 24 months of the termination of his employment, he was entitled to a payout under the plan; namely 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 (UT 3(9)). The Appellant received a sum of £1,236,956 ("the Payment").

The question for the Upper Tribunal was whether the Payment constitutes earnings within the meaning of s.62 Income Tax (Earnings and Pensions) Act ("ITEPA") 2003. The Appellant sought to argue that the Payment is not 'from employment' as it is from 'something else', namely the SARs. Specifically, the SARs fell to be taxed on grant or vesting as this was the 'chargeable event': the point at which they were capable of being turned to pecuniary account under the principle in Abbott v Philbin [1961] AC 352.

Abbott v Philbin

Before turning to Abbott v Philbin, the case of Tennant v Smith requires a mention. In Tennant v Smith [1892] AC 150 the House of Lords held that the yearly value of Mr Tennant's residence in a property provided by his employer could not be brought into account as income as, "the thing sought to be taxed is not income unless it can be turned into money"

(per Lord Halsbury at 157). Rejecting the contention that the value of the residence was £50 on the basis that if he was not required to reside at the property, he "would be compelled to pay that sum for suitable accommodation for himself and family elsewhere", Lord Watson held that 'profits' "in its ordinary acceptation, appears to me to 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 into pecuniary account" (at 159).

The thing of value in Tennant was free accommodation. The thing of value in Abbott v Philbin was an option to acquire shares. The question for the House of Lords in Abbott v Philbin was whether it was the acquisition of the option (in 1954) that was the chargeable event, or its exercise (in 1956) (UT 28-30).

The majority of the House of Lords held that the relevant taxable remuneration was the value of the option at the date of acquisition, not the profit made on its realisation (UT 31) as this was the point at which it was capable of being turned to pecuniary account. It did not matter that the option was not transferable because the grantee could agree with a third party to exercise the option and transfer the shares to him (per Viscount Simonds at p.366). The test was simply whether "it is something which is by its nature capable of being turned into money", and it was irrelevant whether or not it could be valued: "If it had no ascertainable value then it was a perquisite of no value" (Ibid.).

Lord Radcliffe acknowledged that the court was engaged in an exercise of line-drawing, with the share option in issue falling on the right side of the line so as to be taxable on grant, not on exercise, see p 377 and UT 34(2), 67(2). But where that dividing line falls, or the principles to be engaged when analysing these cases, has not – until now – been addressed.

Legislative response

The decision in Abbott v Philbin has since been reversed insofar as it concerns the tax treatment of shares, options and securities. This was done 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. Share options are now dealt with in Chapter 5 of Part 7 ITEPA 2003 (see Grays Timber Products Ltd v HMRC [2010] UKSC 4, [2010] 1 WLR 497 per Lord Walker at [5]).

However, that legislative response has not addressed payment rights which are not securities, options or shares. Abbott v Philbin remains good law and has been applied by the Supreme Court in cases, such as UBS AG v HMRC [2016] UKSC 13, [2016] 1 WLR 1005 ("UBS").

The question, then, was as to its scope: does Abbott v Philbin apply to render any right to payment taxable as soon as it may be turned to pecuniary account, providing it has some value and there is, in theory, a market.

Upper Tribunal decision

The Upper Tribunal considered which features of the SARs distinguished them from the share options in Abbott; in other words, it considered what it was about the 'nature' of the share option which meant it was taxable on grant, rather than exercise. Those features are set out at paragraph 63.

A key feature was that identified by the Court of Appeal in HMRC v PA Holdings Ltd [2011] EWCA Civ 1414, [2012] STC 582 per Moses LJ at [42]; namely that the profit that accrued to Mr Abbott accrued to him in his "capacity as option holder, exercising his discretion as to the best time to exercise his rights having regard to the increase in the value of the shares". Maximising the economic benefits to be derived from the options depended on his "judicious assessment", see Abbott v Philbin 379 and UT 63(5). Whilst this was 'contingent' on him remaining employed (he could not exercise after termination), this was a contingency within his control (he could choose when to exercise his option).

In this case, by contrast, (1) all Mr Saunders could do to increase the value of the SARs and/or hope to receive the Payment was to work and (2) there was no finding that Mr Saunders had any control over the occurrence of the Sale or Liquidity event: he had left his employment in July 2016, and was only informed of the Sale in January 2017 (UT 63(4)). The Payment was not dependent on his judicious exercise of the SAR, or anything connected with the SAR, but on the provision of his personal services.

The issue of what value could be attributed to the SARs was also debated. The Upper Tribunal found that the SARs were, by their nature, different to share options. The latter were “a well-recognised and widely traded asset class, and one which often replicates the economic rights of share ownership” (UT 63(1)), whereas the SARs were a “highly contingent right”, the value of which did not rise and fall with the value of the company generally, but “was specifically linked to the occurrence of one of two forms of one-off transaction (a Sale or a Liquidity Event)” (UT 63(2)).

Conclusion

This decision will be useful to anyone considering emoluments from employment and the extent of the application of the principle in Abbott v Philbin.

A copy of the decision can be found here.

Georgia Hicks appeared as counsel for HMRC.