[2019] UKFTT 210 (TC)

TC07057

Appeal number: TC/2018/02528

CAPITAL GAINS TAX – Entrepreneur's relief - meaning of personal company – meaning of "issued share capital" –* Canada Safeway *followed – not a multi-factorial evaluation – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PHILIP HUNT **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE REDSTON

Sitting in public at the Tribunal Centre, Rosebery Avenue, London on 17 January 2019, with further submissions on 29 January 2019 from HMRC and on 15 February 2019 from the Appellant

Mr D Powrie of Kibworth Tax Services Limited for the Appellant

Mr AJ O'Grady of HM Revenue & Customs' Solicitor's Office for the Respondents

DECISION

Summary

1. The issue in this appeal was whether Mr Hunt was eligible for Entrepreneur's Relief ("ER") on the sale of shares in Foviance Group Ltd ("FGL") on the basis that it was his "personal company" within the meaning of the Taxation of Chargeable Gains Act 1992 ("TCGA"), s 169S. One of the statutory requirements Mr Hunt had to satisfy was that he held at least 5% of FGL's "issued share capital".

2. Mr Hunt completed his self-assessment return on the basis that he satisfied that requirement. Having opened an enquiry, HMRC decided that the statutory provision was only met if a person held 5% of a company's issued share capital by nominal value, which was not Mr Hunt's position.

3. HMRC closed the enquiry and increased the tax payable by £225,451.96; this was later adjusted to £199,751. Mr Hunt appealed to HMRC and subsequently notified his appeal to the Tribunal. For the reasons set out in the main body of this decision, I agreed with HMRC and refused Mr Hunt's appeal.

The evidence

4. HMRC provided a helpful Bundle containing the correspondence between the parties, and other documentation. Mr Hunt provided a witness statement, gave oral evidence, and was cross-examined by Mr O'Grady. He was an honest and credible witness.

5. On the basis of that evidence, I make the findings of fact set out in the following part of this decision. None of those facts was in dispute.

The facts

6. Mr Hunt is a Chartered Accountant with experience of corporate finance and information technology. In early 2007 he was approached by the Chairman of FGL, a specialist web usability and analytics business. At that time, FGL's issued share capital was divided into shares with a £1 nominal value.

7. Mr Hunt agreed to take over as Chairman, and to invest £50,000 in FGL in exchange for shares. FGL's lawyers advised that he subscribe for shares with a 10p nominal value, as this would be more straightforward than obtaining the permission of existing shareholders to issue new £1 shares. He was told that this arrangement would have no impact on his economic interest or his voting rights. Over the following years his shareholding increased as the result of further investments. Share buybacks, share options and a merger also changed his position in relation to the other shareholders.

8. In 2014, FGL decided to seek a buyer, and on 13 August 2015 all the shares were sold to Ernst & Young ("EY"). On that date:

    (1) Mr Hunt's shareholding consisted of 73,448 "E" Ordinary Shares, each with a nominal value of 10p, and 100,000 "B" Ordinary Shares, each with a nominal value of £1;

(2) there were 2,198,355 issued shares, of which Mr Hunt held 173,448, 5.94% of the total;

(3) the nominal value of those issued shares was £2,576,483; the nominal value of those owned by Mr Hunt was £107,344, or 4.16% of the total; and

(4) the total number of votes attributable to the issued shares was 2,794, 835; Mr Hunt's shares gave him 173,448 votes, or 6.21% of the total.

9. In the course of the sale negotiations, EY had pointed out to Mr Hunt that his shareholding might not qualify for ER, because he did not hold at least 5% of FGL's nominal share capital. They suggested he might wish to "recapitalise" his 10p shares so that they became £1 shares, and then wait for a year so that the ER minimum holding period was met. However, Mr Hunt decided that a prompt sale was in FGL's best interest, and did not delay the transaction.

10. After the sale to EY, Mr Hunt took advice from Mr Powrie, and in due course completed his SA return claiming ER on his share sale. HMRC opened an enquiry, decided that Mr Hunt was not entitled to ER, and increased the tax due by £225,451.96; this figure was subsequently reduced to £199,751. Mr Hunt appealed, and subsequently notified his appeal to the Tribunal.

The legislation

11. The ER legislation is at TCGA, Part V, Chapter 3. That Chapter begins with s 169H, which provides that ER applies to "qualifying business disposals" including "a material disposal of business assets".

12. Section 169I defines that term as including "a disposal of one or more assets consisting of (or of interests in) shares in or securities of a company", providing the shares meet one of Conditions A to D. It was common ground that only Condition A was relevant. It reads:

> "Condition A is that, throughout the period of 1 year ending with the date of the disposal–
>
> (a) the company is the individual's personal company and is either a trading company or the holding company of a trading group, and
>
> (b) the individual is an officer or employee of the company or (if the company is a member of a trading group) of one or more companies which are members of the trading group."

13. There was no dispute that Mr Hunt met (b) above, as he had been a director of FGL for over a year; the dispute turned on the whether the shares he held were in a "personal company" as required by (a) above. The term "personal company" is defined at TCGA s 169S(3):

> "For the purposes of this Chapter 'personal company', in relation to an individual, means a company–
>
> (a) at least 5% of the ordinary share capital of which is held by the individual, and

> (b) at least 5% of the voting rights in which are exercisable by the individual by virtue of that holding."

14. Since Mr Hunt held more than 5% of the voting rights in FGL, the issue was with the phrase "5% of the ordinary share capital". TCGA s 169S(5) provides that "ordinary share capital" has the same meaning as in ITA 2007 s 989, and that definition reads:

> "'ordinary share capital', in relation to a company, means all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits."

15. None of the shares which Mr Hunt had taken into account when claiming ER were ones where "the holders…have a right to a dividend at a fixed rate but have no other right to share in the company's profits". Thus, the only issue was the meaning of the phrase "the company's issued share capital". HMRC's view was that this meant 5% of the nominal value of the shares in issue. Mr Powrie disagreed, for the reasons set out below.

The case law

16. Two authorities were relied on, *Canada Safeway v IRC* [1972] 1 All ER 666 ("*Canada Safeway*") and *R&C Commrs v Taylor and Haimendorf* [2010] UKUT 417 (TCC) ("*Taylor and Haimendorf*"). I consider them in turn.

Canada Safeway

17. The facts of this case were as follows:

(1) Canada Safeway had issued 280,000 "common shares" of $10 each, so a total nominal value of $2.8m. They had a market value of $195m. All were owned by Safeway Stores Inc ("American Safeway").

(2) Canada Safeway had also issued 62,387 preference shares of $100 each, so a total nominal value of $6,238,700. The market value of these shares was less than $7m.

(3) The combined nominal value of all the issued shares was therefore $9,038,700, of which American Safeway owned 30.9%.

(4) The combined market value of the shares was around £102m, of which American Safeway owned 93%.

(5) American Safeway also owned shares in a third company, English Safeway. It sold those shares to Canada Safeway, and claimed that it was entitled to an exemption from UK stamp duty because it owned more than 90% of both English Safeway and Canada Safeway. The relevant statutory exemption applied if one company owned not less than 90% of the "issued share capital" of the other.

(6) The Inland Revenue disagreed with Canada Safeway, and their view was upheld by the Special Commissioners. Canada Safeway appealed to the High Court, where the case was heard by Megarry J.

18. Counsel for Canada Safeway submitted that:

> "Where, as here, one company has, by actual value, what in substance is the overwhelming ownership of another company, it was unreasonable that effect should be denied to that overwhelming ownership merely because the nominal value of the shares fell short of the requisite percentage. Where there was only one class of shares, either test would naturally produce the same result; but where, as here, there were two classes, and the two tests produced different results, effect should be given to the test of actual value, thus preferring substance to form."

19. McGarry J pointed out that "in the statutory phrase…the percentage relates to the 'issued share capital', and not 'issued shares'". He referred to Companies Act 1948, s 2(4), which read:

> "In the case of a company having a share capital (a) the memorandum must also…state the amount of share capital with which the company proposes to be registered and the division thereof into shares of a fixed amount…"

20. He said that the concept of a "share capital…divided into shares of a fixed amount" was "a concept wholly removed from whatever fluctuating value may be put upon those shares from time to time". The stamp duty provision in issue referred to "90 per cent of the issued share capital", which was "entirely consonant" with the term "share capital" in the Companies Act, and continued:

> "The word 'capital' seems to me to be a word which in this context is inept if it is intended to convey the idea of actual values, The capital of a company may remain wholly unchanged while estimates of the value of the company's assets or its undertaking or its shares fluctuate greatly on the stock exchange and elsewhere. To proffer a percentage of the value of the issued share capital is no compliance with a statutory demand for a percentage of the issued share capital itself."

21. He accepted that there might be cases "which seem to fall within the general object or purpose of section 42 but fail to satisfy its terms", but added:

> "that cannot alter the effect of the words used. Given a general object, the draftsman, in looking for a simple and workable test, may hit upon a formula which gives substantial effect to the general purpose, but is liable to include some marginal cases that ought to be excluded, or exclude some marginal cases that ought to be included. It may be possible to achieve an exact coincidence between the purpose and the test only at the expense of deplorable complexity; and so in the end the simpler test may remain, with whatever marginal faults it may have. In such cases, the duty of the court is to put a fair meaning on the language actually used, and not to adopt a Procrustean distortion in order to fit what may be thought to be the overriding purpose of the section. The reasons for laying down a rule must not be confounded with the rule itself…"

22. He concluded that:

> "In the present case, I can see no good reason for ousting the *prima facie* construction of the phrase in question, and good reason for adhering to it. The test of nominal value is simple, workable and, above all, related to the words 'share capital'".

23. In the course of his judgment, McGarry J also considered the following hypothetical example:

> "…there are 950 shares of 5p each and 50 shares of £1 each. The owner of the 950 shares owns more than 90 per cent. of the shares, but holds far less than 90 per cent. of the nominal value of the shares."

24. He went on to say that "rightly, nobody has suggested to me that the test could be the number of shares, rather than the nominal value or the actual value".

Taylor and Haimendorf

25. This issue in this case was whether Mr Taylor and Mr Haimendorf were "connected" with a company in which they had invested, and so prevented from claiming relief under the Enterprise Investment Scheme ("EIS"). The relevant legislation provided that:

> "(1) An individual is connected with the issuing company if he directly or indirectly possesses or is entitled to acquire more than 30 per cent of–
>
> (a) the issued ordinary share capital of the company or any subsidiary,
>
> (b) the loan capital and issued share capital of the company or any subsidiary, or
>
> (c) the voting power in the company or any subsidiary."

26. In order to resolve that issue, Roth J needed to decide what was meant by "the issued ordinary share capital of the company". He cited extensively from *Canada Safeway,* saying McGarry J's analysis was "closely based on the statutory language" and that the expression "issued share capital" appears frequently in the Income and Corporation Taxes Act ("ICTA"), and it "would be a striking result if the same form of words were to receive a very different interpretation within the same statute". Had that been the intention, the parliamentary draftsman would have included a "distinct definition" for the purposes of the EIS provisions. McGarry J concluded that part of his judgment by saying at [17]:

> "In the absence of such special definition, I consider that the phrase must receive the same meaning throughout the ICTA. That meaning has been well-established since the *Canada Safeway* judgment that has been applied for almost 40 years. Accordingly, I consider that it is clear that issued share capital in paragraph (b) refers to the nominal value of the shares."

The submissions

27. Mr O'Grady submitted that it was clear from *Canada Safeway* that the words "issued share capital" referred to the nominal value of the shares. That this was correct had been confirmed by Roth J in *Taylor and Haimendorf.* Although neither case considered the ER legislation, the term used was the same. and in his submission, the meaning was also the same.

28. Mr Powrie's main submission was that the purpose of the ER provisions was to provide a lower rate of tax to those who had made a real and material commitment to a business, and that to refuse ER to a person such as Mr Hunt, who had more than 5% of the votes, more than 5% of the dividend rights and more than 5% of the capital on liquidation but less than 5% by nominal value "cannot be the right test". Instead, the Tribunal should take a purposive, multi-factorial approach to determine whether a person owed 5% of the company from an overall economic point of view, and in carrying out that exercise, should take into account rights to vote, rights to receive dividends, and rights to receive capital on a winding up.

29. In his skeleton argument, Mr Powrie also said that "if you add up the total number of shares in issue, and apply the 5% test to that, Mr Hunt satisfies the test". His original advice, which formed Mr Hunt's grounds of appeal to the Tribunal, stated that "when we are asked whether you have 5% of the ordinary share capital, we simply add up the number of shares and we know that you satisfy the test".

30. Mr Powrie made the following submissions in relation to *Canada Safeway*:

(1) it concerned a definition within the stamp duty legislation, and so was not binding on this Tribunal, which was being asked to rule on an ER provision;

(2) it was concerned with whether ordinary share capital should be interpreted by reference to market value, and that argument was not being put forward here;

(3) McGarry J's comment that "rightly, nobody has suggested to me that the test could be the number of shares" was on any view *obiter,* and was simply a "judicial gloss" which the Tribunal should ignore; and

(4) the case was decided in 1972, when tax legislation was not interpreted in a purposive way.

Companies Act 2006

31. Noting that *Canada Safeway* made reference to the Companies Act 1948, I asked the parties if they had considered whether the position was affected by the wording used in Companies Act 2006. They had not done so, but provided written submissions after the hearing. Both confirmed that they did not require the hearing to be resumed so they could make oral submissions.

32. Mr O'Grady's supplementary submission referred to s 540(1) of the Companies Act, which reads:

> "In the Companies Acts 'share', in relation to a company, means share in the company's share capital."

33. He also referred to s 542 of that Act, which is headed "notional share capital" and reads:

> "Shares in a limited company having a share capital must each have a fixed nominal value."

34. Mr O'Grady said that the position was therefore essentially unchanged from that in Companies Act 1948, which, as McGarry J had said, contained the concept of "share capital…divided into shares of a fixed amount".

35. Mr Powrie had no comments on Mr O'Grady's submissions, but said that the Companies Act generally required that matters be decided by way of votes, and so was not of assistance in resolving this appeal.

The Tribunal's view

36. I first set out my conclusion, and then explain why I have not accepted the other alternatives.

The nominal value?

37. The statutory context of this appeal is different from that considered in *Canada Safeway*. I therefore agree with Mr Powrie that *Canada Safeway* is therefore not binding on me. However, like Roth J in *Taylor and Haimendorf,* I respectfully concur with McGarry J's analysis.

38. McGarry J said that the statutory phrase was (my emphasis) "issued share <u>capital</u>"; it was not "issued <u>shares</u>". The Companies Act 1948 stated that "share capital" had to be divided into "shares of a fixed amount", and McGarry J inferred that the statutory phrase must therefore refer to their nominal value, which was fixed, and not to market value, which was variable.

39. The position is the same today. In the Companies Act 2006 "shares" are defined as "shares in the company's share capital" each with "a fixed nominal value". Both Acts state that share capital is divided into shares each of which has a fixed nominal value.

40. Noting Roth J's reference to the number of times the term "issued share capital" appears in ICTA, I asked the parties whether they had considered other usages within the TCGA, but neither had done so. My own quick review identified six usages:

(1) s 184C(5) – meaning of "qualifying change of ownership";

(2) s 228(9) – a rollover relief condition;

(3) s 239(6)(a) – disposals to trustees of ESOPs;

(4) Sch C1 Section 14F para 7(2) – the meaning of "closely held company";

(5) Sch 5B para 14AA – reinvestment in an EIS; and

(6) Sch 7A (7) – pre-entry losses.

41. There are also over a hundred references to “ordinary share capital”, the term used in TCGA s 169S. Again, as far as I was able to ascertain, the meaning of that term was either cross-referenced to ITA s 989, or to the same definition in Corporation Tax Act 2010, s 1119, so these further references are also, indirectly, to “issued share capital”.

42. Although I did not have the benefit of submissions on this point, I agree with Roth J that it would be startling if the term had different meanings in different parts of the same Act. The meaning established by McGarry J in *Canada Safeway* is, as he said, “simple, workable and, above all, related to the words ‘share capital’”, and so can easily be applied to the many other situations in which the term appears, unlike the multi-factorial alternative suggested by Mr Powrie, which I consider in the next following paragraphs.

Multi-factorial test?

43. Mr Powrie’s main submission was that the provision should be read as requiring a multi-factorial test, which took into account rights to vote, rights to receive dividends, and right to receive capital on a winding up.

44. One of these elements is already set out in the statute – s 169S(3)(a) requires that the person have “at least 5% of the voting rights” as the result of his shareholding. More generally, tax law does of course contain multi-factorial tests. Well-known examples include the tests for employment status (see *Hall v Lorimer* [1994] STC 23); establishing whether an item is zero rated or standard rated (see *Procter & Gamble UK v HMRC* [2009] EWCA Civ 147), and whether a person is carrying out a trade (see *Samarkand Film Partnership No 3 v Revenue and Customs Comrs* [2017] EWCA Civ 77). A multi-factorial evaluation is required in these situations because the statute typically sets out the different consequences arising from the alternative outcomes but does not list a detailed set of conditions which must be satisfied. It is therefore left to the courts to work out the boundary between employment and self-employment, between standard and zero-rated food, and between a trade and a hobby, and they do this by considering a number of relevant factors.

45. The position here is very different. The ER legislation is highly prescriptive:

(1) it requires a “qualifying business disposal”, defined as a “material disposal of business assets” or a “disposal of trust business assets” or a “disposal associated with a relevant material disposal” (s 169H);

(2) each of those terms is further defined, so that for example a “material disposal of business assets” requires an individual to make a disposal of business assets which is “a material disposal” (s 169I(1), and the meaning of those terms is set out in the rest of that section, which itself runs to 26 sub-sections;

(3) further specific, carefully formulated provisions set out the requirements for a claim (s 169M); the calculation of quantum (ss 169N-P); and the application of the provisions in cases of a re-organisation (s 169N); and

(4) s 169S contains interpretive provisions.

46. Mr Hunt has already met the following detailed requirements:

(1) his shares were held for one year or more (s 169I(6));

(2) FGL is a trading company or the holding company of a trading group (s 169I(6)(a));

(3) Mr Hunt was an officer of the company (s 169I(6)(b));

(4) he held at least 5% of the voting rights (s 169S(3)(a)); and

(5) none of those shares had a right to a dividend at a fixed rate but no other right to share in the company's profits (s 169S(5) read with ITA 2007 s 989).

47. The only remaining requirement is whether Mr Hunt holds 5% of the issued share capital. If that term means "5% of the nominal value" he will fail to satisfy the ER requirements. It is not possible to replace that requirement by a multifactorial test importing other requirements – such as dividend rights or rights to capital on a winding up – which are not referred to in the statute. Instead, the Tribunal's task is to decide what is meant by the term "issued share capital".

48. My analysis is set out above. I add that the draftsman of prescriptive ER provisions can reasonably be assumed to have used a term which he understood had a clear meaning, rather than a multi-factorial test. As McGarry J said:

> "there is no good reason for ousting the *prima facie* construction of the phrase in question, and good reason for adhering to it. The test of nominal value is simple, workable and, above all, related to the words 'share capital'."

Purposive?

49. Mr Powrie submitted that a purposive interpretation of the statute means that my conclusion is wrong, and a different answer is required, one that allows a person in the position of Mr Hunt, who was clearly an investor in the business, to benefit from the relief.

50. In *Astall v HMRC* [2010] STC 137 ("*Astall*") at [44], Arden J, giving the leading judgment with which the rest of the Court of Appeal concurred, said that "the purpose must be discernible from the statute: the court must not infer one without a proper foundation for doing so". Similarly, in *Trigg v HMRC* [2018] EWCA Civ 17, the taxpayer argued for a purposive construction of TCGA s 117. Patten LJ, giving the only judgment with which Floyd and Hamblin LJJ both agreed, said that much of the case law on purposive construction was informed by the tax avoidance context, which was not the position in *Trigg*. However, he went on to say at [24] that:

> "any exercise in construction must begin with the words used and one is therefore immediately drawn into a consideration (similar to that in the tax scheme cases) of whether particular components of [the relevant statutory provision] should be given their literal or some kind of qualified meaning."

51. The purpose of the ER provisions is discernible from the statute. It is to allow relief for "qualifying businesses". As explained above, the legislation then goes on to prescribe exactly what is meant by a "qualifying business". As a result of those detailed provisions, ER is not available to a shareholder who holds less than 5% of the issued share capital. It is not possible to infer, in reliance on the general purpose of the ER legislation, that this requirement can be bypassed.

52. Mr Powrie's submissions were similar to those of Counsel for the appellant in *Canada Safeway,* who said that where "one company has, by actual value, what in substance is the overwhelming ownership of another company, it was unreasonable that effect should be denied to that overwhelming ownership merely because the nominal value of the shares fell short of the requisite percentage". Responding to that submission, McGarry J recognised that there may be cases which "seem to fall within the general object or purpose" of the section, but which "failed to satisfy its terms". He added that this is commonly an inevitable consequence of a introducing a simple and workable test. The position is the same here: Mr Hunt is an example of a "marginal case". Although he is excluded from ER "the duty of the court is to put a fair meaning on the language actually used", because "the reasons for laying down a rule must not be confounded with the rule itself".

The number of shares?

53. Mr Powrie also put forward, somewhat diffidently, the alternative proposition that if "you add up the total number of shares in issue, and apply the 5% test to that, Mr Hunt satisfies the test", and he invited me to disregard McGarry J's comment that this was incorrect, on the basis that it was *obiter* and merely a "judicial gloss".

54. McGarry J's comment is not binding on me, but I agree with it. The statutory definition refers to a percentage of a company's "issued share capital", not to a percentage of the number of shares.

Decision and appeal rights

55. For the reasons set out above, I find that 5% of a company's "issued share capital" means "5% of the total nominal value of a company's share capital". As a result, I refuse Mr Hunt's appeal and uphold HMRC's amendment to his tax return.

56. 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.

ANNE REDSTON
TRIBUNAL JUDGE

RELEASE DATE: 26 MARCH 2019