[2014] UKFTT 426 (TC)

TC03555

Appeal numbers: TC/2012/08990, TC/2012/08988, TC/2012/09286 & TC/2012/09115

Income Tax - Forfeiture of relief in relation to Enterprise Investment Scheme ("EIS") - Acquisition of the company in which the Appellants and many others held shares, the subscription for which had qualified for EIS relief, by another company - Whether that acquisition had occasioned a fatal "change of control" and a "disposal" of the relevant shares, or whether the rollover provision of section 247 Income Tax Act 2007 eliminated those two results - Whether the acquiring company's only issued shares at the time of the acquisition were "subscriber shares" - Appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

AVERIL FINN
GREGORY FINN
ROBIN MORRIS
-and-
ANDREW CORNISH **Appellants**

-and-

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

TRIBUNAL: JUDGE HOWARD M. NOWLAN
MRS SHAMEEM AKHTAR

Sitting in public at Seacourt Tower, Oxford on 29 April 2014

The Appellants in person

Simon Foxwell of HMRC on behalf of the Respondents

DECISION

Introduction

1. This is a very unfortunate case where various shareholders, including the four Appellants in this Appeal, have forfeited the EIS relief initially obtained on acquiring the shares in a start-up company. The Appellants will be highly aggrieved by this outcome since they will unquestionably be unable to understand any policy reason why the transaction that will have undermined their retention of EIS relief should have had that result. Had the relevant transaction been effected in other ways, they would not have forfeited their relief, albeit that for entirely non-tax reasons it appears that they could not have so implemented the overall transaction in the relevant different manner. The Appellants will certainly feel that, having subscribed shares in the intended sort of start-up company, as they were encouraged to do, it is extraordinary that they lose their relief in a manner that until the hearing they had failed even to understand fully.

2. For our part, while we have no doubt that the conclusion that we have reached is the correct legal conclusion, we do accept that we had initially not found the strict interpretation of the crucial provision (section 247 Income Tax Act, 2007) that might have preserved the Appellant's relief to be unambiguous. Furthermore, in our endeavour to interpret the provision in a purposive manner, we had failed to understand why the relevant provision had been inserted, as it transpires, to offer protection from forfeiture of the relief in just one very narrow circumstance, and difficult to understand why a slightly wider form of protection from forfeiture of the relief had not been provided for. The correct interpretation of the provision, we now consider, is clear so that those observations are of no significance. We are certainly unable to modify our interpretation of the section in order to achieve what we perceive to be some manifest statutory purpose, because nothing indicates any such more general statutory purpose.

The facts

3. The facts were relatively simple.

4. The Appellants and other investors subscribed shares in a start-up company called ProtonStar LED Limited ("ProtonStar"). ProtonStar conducted some trade as its name suggests in relation to LED lighting, and all the requirements for enabling those subscribing the shares to secure EIS relief were satisfied. We believe that the share subscriptions took place in 2010 but all that matters for the purpose of this Appeal is that the later transactions with which we are concerned took place well within the three-year period during which certain requirements have to be met to avoid the forfeiture of the relief initially granted.

5. It was certainly the case that some shareholders, including at least one of the present Appellants, subscribed shares at a later date than that on which the initial subscriptions were made by the initial shareholders. EIS relief was obtained in respect of those later subscriptions, and the only difference material to the later subscribers was that their 3-year period obviously commenced to run in relation to the later acquired shares at the relevant slightly later date.

6. Nothing turns on the present point, but we were informed that all the shares issued were shares with a very low nominal amount, subscribed at a very substantial premium. Whether

matters were then adjusted with the share premium account being capitalised upon the issue of further shares was not clear. If this did occur, it seems presently to be irrelevant.

7. Another quite separate company called Enfis Limited ("Enfis") had been formed in Wales somewhat earlier than ProtonStar. Enfis appeared also to have traded in LED lighting, and many of its shareholders had also secured EIS relief on subscribing their shares. We believe that all those shareholders had held their shares for the 3-year period during which the various conditions for preservation of the relief had to be satisfied. It may be that there were further share issues at later dates than the initial issue and there was also a reference to Enfis having made a bonus issue of shares. Since we were told that Enfis had generally traded unsuccessfully and incurred losses, we imagine that there would have been no profits to capitalise by way of bonus issue, but Enfis might have issued further shares on capitalising share premium account. Again, whether it did or not seems largely irrelevant.

8. While Enfis had traded unsuccessfully, it did have one attribute that appealed to ProtonStar and ProtonStar's shareholders which was that it had secured an AIM listing. Obtaining such a listing is costly, and the listing cannot be transferred to another company. The broad objective of the ProtonStar shareholders was to acquire Enfis, make whatever use could be made of Enfis's hitherto loss-making trade, and critically secure the benefit of Enfis's AIM listing. Since this last objective could not have been achieved had ProtonStar acquired Enfis, the intended merger was achieved by a reverse take-over in which Enfis acquired ProtonStar. The preliminary step to this transaction was that Enfis dropped down its trade to a newly-formED subsidiary. Enfis then acquired all the shares in ProtonStar in exchange for an issue of 78% of the enlarged capital of Enfis, leaving the old Enfis shareholders naturally with 22% of the shares of Enfis. The name of Enfis was then changed to ProtonStar LED Group Plc ("Group"). The result therefore was that Group held both subsidiaries, ProtonStar and the subsidiary to which Enfis's trade had been transferred.

9. We were told that when the above transaction was implemented the shareholders in ProtonStar secured clearances from HMRC confirming that the share exchange was effected for *bona fide* commercial reasons, and that there was to be no counteraction of any feature of the transactions under the "transaction in securities" provisions. Attention was also being given to ensure that Group would continue to be a company whose further shares could be subscribed with the benefit of EIS relief. In particular great care was given to ensuring that the combined number of employees was kept below the then limit for EIS purposes of 50. HMRC gave an express confirmation that future share issues would qualify for EIS relief assuming that they met the various other conditions.

10. We understand that one other event occurred, though it was accepted by both parties that this was immaterial to the dispute in this case. Group apparently acquired a third trading company involved in the actual manufacture of LED lighting, and this acquisition put the number of employees above the then relevant limit. It appeared, however, to be common ground that this event would have had no effect on the retention of EIS relief for shareholders who had initially secured that relief, even though the event occurred during the relevant 3-year period for those shareholders. It did undermine the ability to issue new shares to new subscribers in a manner that would then attract EIS relief but this is of course of no direct concern to the issue in this Appeal.

11. The issue in this Appeal is simply whether the take-over by Enfis of ProtonStar has resulted in the forfeiture of EIS relief for the pre-existing shareholders in ProtonStar, the four Appellants being some of the shareholders in question.

The law and our decision

12. We are concerned with three provisions, namely sections 185, 209 and 247 of Income Tax Act, 2007.

13. Section 185 provided that EIS relief would be forfeited if within the relevant 3-year period ProtonStar came under the control of another company, it being specifically stated that ProtonStar would suffer a change of control if it became a 51% subsidiary of another company. There appeared to be no qualification to this rule along the lines of a provision saying that since the old ProtonStar shareholders held 78% of the shares in Group, and thus indirectly 78% control of ProtonStar there should be deemed not to have been a change of control of ProtonStar at all.

14. Section 209 provided that the EIS relief was to be partially or wholly withdrawn if the shareholders of ProtonStar disposed of their shares within the relevant period. We gave thought to the issue of whether we might conclude that the shareholders had not disposed of their shares because for capital gains purposes it was clear that the share swap would have led to the clear result for capital gains purposes that there would have been no disposal. We concluded that while this capital gains result would obviously have followed, this was almost certainly irrelevant to the different code concerned with the preservation or forfeiture of EIS relief, since there is a quite clear provision in the EIS code that does nullify the disposal where its conditions are satisfied. That is the third provision with which we are concerned, namely section 247. The problem for the present Appellants is that there is a further condition that has to be satisfied for section 247 to have effect, and our conclusion is that that condition is not satisfied. The fact that section 247 is capable, where its conditions are satisfied, of nullifying the consequences of both a change of control under section 185 and a disposal of shares under section 209, does appear to put it beyond doubt that it is only where the conditions of section 247 are satisfied that sections 185 and 209 can be disapplied.

15. Section 247 is drafted in a slightly curious manner. It disapplies both sections 185 and 209 where another company acquires the shares in ProtonStar entirely for shares, and where all the various *bona fide* requirements have been satisfied, as they have been in the present case. There is however the additional requirement that the company issuing the shares must be a company prior to the acquisition, *"in which the only issued shares are subscriber shares"*. We are not meant to rely on the section headings in interpreting the statutory provisions, but we might mention that the section heading to section 247 is *"Continuity of EIS relief where issuing company is acquired by new company"*. The reference there to "new company" is of some significance though it is not required for the purposes of the conclusion that we have reached.

16. The respect in which we say that the drafting of section 247 is slightly curious, is that other taxation provisions that provide some form of relief when a pure new holding company (with nothing in it) acquires the shares of another company in exchange for shares do make it abundantly clear that the relief in question applies only where the acquiring company is held in exactly the same proportions as the old company was held, so that it is clear that the new company is a shell company with no material existing shareholders at all. A particular

stamp duty relieving provision contains very strict requirements that make this limited application of the section absolutely clear.

17. There was no definition of the expression "subscriber shares" for the purposes of section 247, or even (so far as we have been able to ascertain) anywhere in the tax or indeed the company law legislation. There is no doubt that to a company lawyer, the natural meaning of "subscriber shares" is the shares that are to be issued to those who subscribe to the Memorandum of Association of the company on its initial formation. Generally the subscribers will only subscribe nominal shares, perhaps two shares only (particularly where the company is formed by company formation specialists), but it is certainly theoretically possible, for instance, for a start-up company to be incorporated by 10 shareholders who each subscribe to the Memorandum of Association which provides that each will acquire shares on subscribing £100,000 each, in which case those shares would plainly be subscriber shares and the company with £1 million in it, ready and able to trade, would be a company, at least until the issue of any further shares, that had only subscriber shares in issue.

18. Leaving aside the company lawyer's natural construction of the phrase "subscriber shares" it was claimed by the Appellants that it was inconceivable that Parliament had intended the old ProtonStar shareholders to forfeit their relief when:

- Enfis had also been a trading company whose shareholders had qualified for EIS relief;
- the other conditions for the preservation of EIS relief for the ProtonStar shareholders had been satisfied;
- HMRC had confirmed that any new shares issued by Group would potentially qualify for EIS relief; and
- the merger of the two companies was entirely commercial.

We entirely understand this claim. It seems curious that there is a relieving provision that disapplies sections 185 and 209 in a rather remote circumstance (the super-imposition on top of ProtonStar of what will almost inevitably be a pure new holding company), and no relieving provision where entirely for trade purposes two EIS companies are merged together, such that the combined company still satisfies all the requirements necessary for future share issues to qualify for EIS relief. Indeed, it is particularly odd that in that take-over situation the former shareholders of the acquiring company would appear not to forfeit their relief while the former shareholders of the target company would forfeit their relief. This may be irrelevant in this case because the Enfis shareholders had all held their shares for more than three years, but the general point is a fair one, and it is somewhat odd.

19. In response to the suggestion by the Appellants that we should seek to interpret section 247 in a purposive manner that would not undermine their EIS relief, we gave consideration to whether it was possible to construe the phrase "subscriber shares" in a different and more general manner so as to mean "any shares that had been subscribed". While the company lawyer might find it to be absolutely clear that the expression "subscriber shares" has the meaning that we indicated in paragraph 17 above, it is worth noting that in many other circumstances the word "subscribe" is used to refer to any subscription of new shares for value by a shareholder. Thus it is commonplace to refer to shareholders to whom new shares are issued for value subscribing shares, and equally commonplace to refer to existing shareholders taking up shares on a rights issue as subscribing shares in that situation. One would never refer to shareholders receiving bonus shares as subscribing shares because there

is then no notion of something (cash or other value) being subscribed on the issue of the shares. Equally obviously a purchaser of shares must be said to have purchased shares, and not subscribed them, but if the seller was a person who had initially subscribed the shares, from the perspective of the company, one might still refer to the shares that the purchaser bought as shares that had been subscribed.

20. In support of the endeavour to interpret the expression "subscriber shares" in a much more general manner than we indicated in paragraph 17 above, the Appellants drew to our attention the fact that even HMRC's forms material on applying for EIS relief on any new issue of shares referred to the shareholder subscribing shares. This is, we accept, an entirely proper description of the situation where shares are subscribed for cash, but when there is no actual definition of "subscriber shares" for the purposes of section 247 (or, indeed, as we have suggested for any other purpose in the tax or company law legislation) the average taxpayer can perhaps be forgiven for failing to understand that when he has subscribed for shares the shares may not be said to be "subscriber" shares unless he subscribed those shares, as a subscriber to the Memorandum of Association.

21. HMRC's representative very fairly drew our attention to some non-statutory commentary by HMRC that referred to the shares that had to be in issue, prior to the share exchange contemplated by section 247, as "original subscriber shares". This was a slightly two-edged reference because while it made it clear that HMRC expected the reference to subscriber shares to have the meaning that we have indicated in paragraph 17 above, HMRC only made this clear by adding the word "original" to the expression, when that word was obviously not included in the text of section 247.

Our conclusion

22. Our reluctant conclusion is that, while we sympathise with the present Appellants and can well understand that they will feel aggrieved by our decision, we must abide by the very clear expectation that the expression "subscriber shares" does not mean any shares that have been subscribed. It has the meaning that we gave in paragraph 17 above, in other words those shares issued to the subscribers to the Memorandum of Association.

23. The fundamental reason for this decision is that the expression is a technical one to a company lawyer, and it then has the clear meaning that we have indicated in paragraph 17 above, and it is impossible to interpret a phrase that in its context has a well-understood meaning by considering the interpretation that some non-specialist might put on the expression.

24. We also note the powerful point that there is an express requirement that the shares previously in issue by the acquiring company contemplated by section 247 must be subscriber shares, and if we ask which shares would undermine that requirement if the expression referred to "any shares that had been subscribed", we would end up with a nonsensical result. The only shares, from the perspective of the company (as opposed to purchasing shareholders) that would not then be said to be "subscriber shares" would be bonus shares, or quite possibly as well, shares issued on the capitalisation of share premium account. We can see absolutely no sense to having a requirement that the pre-existing shares be "subscriber shares", and then only excluding bonus and capitalisation shares from the qualifying category. The subsequent issue of such shares would obviously have been

completely immaterial, and a conclusion that would only exclude such shares from the definition is incoherent.

25. We admit that there is an anomaly in the other direction, as we mentioned in paragraph 17 above, in that if by pure chance the pre-existing shares of the acquiring company for the purposes of 247 all happened to have been subscribed by the subscribers to the Memorandum of Association (say for £100,000 each as we suggested in paragraph 17) those shares would plainly not preclude the application of section 247 if that company, having issued no further shares, happened to be the acquiring company. We can only conclude that this was first not a situation that occurred to the draftsman, and secondly that it is not a state of affairs that could be brought about intentionally. It would only be material in those rare situations (and there certainly have been such situations) where the subscriber shares were subscribed in the manner we speculated in paragraph 17 by the 10 subscribers, and the facts could not be generated at the point of an acquisition by a company formed in the more conventional manner when the main share issues had all followed the formation.

26. Our conclusion is accordingly that since we were told that the shares in Enfis had been issued on different occasions, and reference was even made to there having been a capitalisation issue of some sort, we conclude that the pre-existing shareholders in ProtonStar did forfeit their EIS relief on the takeover and that this Appeal is dismissed. We can only add that we are unable to explain to the Appellants why:

- Parliament provided for preservation of the various reliefs in the narrow situation of the super-imposition of a pure new holding company;
- no relief was provided in the situation orfan entirely commercial pure share takeover of one EIS company by another; and
- why in that situation just referred to the shareholders of one company would appear to forfeit their relief while those in the other might well not do so.

Right of Appeal

27. This document contains full findings of fact and the reasons for our decision in relation to each appeal. Any party dissatisfied with the decision relevant to it 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.

HOWARD M NOWLAN
TRIBUNAL JUDGE

RELEASE DATE: 9 May 2014