[2015] UKFTT 0558 (TC)

TC04710

Appeal number: TC/2014/04039

INCOME TAX – enterprise investment scheme – whether small or insignificant preferential rights attaching to shares could be ignored – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

FLIX INNOVATIONS LTD **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at Fox Court, Brooke Street, London on 12 October 2015

Joseph Howard, Counsel, for the Appellant

Simon Foxwell, Officer of HM Revenue & Customs, for the Respondents

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DECISION

1. Part 5 of the Income Tax Act 2007 ("ITA 2007") sets out the details of the "enterprise investment scheme" that provides for a tax relief ("EIS relief") to be available when individuals subscribe for shares in qualifying companies.

2. The relevant provision for the purposes of this appeal is that set out in s173(2)(aa) of ITA 2007 which stipulates that the shares being acquired must not carry "any present or future preferential right to a company's assets on its winding up". HMRC assert that shares issued in or around July 2013 did carry such a preferential right with the result that their issue could not benefit from EIS relief. The appellant, Flix Innovations Ltd (the "Company"), disputes this.

3. In form, the Company appeals against:

(1) HMRC's decision of 30 September 2013 to refuse to authorise the Company to issue "compliance certificates" confirming that the ordinary shares issued could benefit from EIS relief ; and

(2) HMRC's decision to withdraw EIS relief claimed and already allowed in respect of shares that the Company had issued with a "termination date", for the purposes of EIS relief, falling after 22 May 2013.

4. The parties seemed agreed at the hearing that the two parts to the Company's appeal stood or fell together. In the course of writing this decision, for reasons set out in more detail at [43] and [44], I have come to the conclusion that any appeal against the decision set out at [3(2)] above would need to be brought by individual investors in the Company. However, it is clear that the Company does have standing to appeal against the decision referred to in [3(1)] above and, accordingly, it is that issue with which this decision is primarily concerned.

Evidence

5. Few, if any, of the principal facts in this appeal were in dispute.

6. On behalf of the Company, the Tribunal had a witness statement from Mr Brendan Fearn and Mr Stephen Kimbell, who are both directors of the Company. They supplemented that evidence with some oral evidence and Officer Foxwell cross-examined them. I found both Mr Fearn and Mr Kimbell to be honest and reliable witnesses and I have accepted their evidence.

7. No witness evidence was put forward on behalf of HMRC.

8. In addition, I had documentary evidence that was set out in a helpful bundle that the Company's advisers had prepared.

Findings of fact

9. The facts set out at [10] to [36] were either not in dispute or were determined by the Tribunal.

Background

5 10. The Company carries on a business of developing and providing a high-technology internet-based method of delivering digital content to cinemas. Instead of delivering physical reels of film to the cinema, the Company has developed a method of delivering film digitally.

11. The Company has two founding members, Mr Fearn and Mr Kenneth Phelan. 10 Prior to the transactions described at [22], [23] and [25] below (the "2013 Reorganisation") the Company's share capital was divided into two classes. Mr Fearn and Mr Phelan, in their capacity as founders of the Company, had A Shares which were also known as "founders' shares". Other investors in the company held B Shares. The A Shares and B Shares both had a nominal value of £0.0001, had 15 identical economic rights and each carried one vote at a general meeting of the Company. However, the holders of the A Shares had the right to appoint a director who would have to be present at a board meeting of the company for that meeting to be quorate. Accordingly, while the economic rights of the A Shares were identical to those of the B Shares, the A Shares ensured that the founders of the company would 20 retain a measure of representation on the board of the Company no matter who the holders of the B Shares were, or how many B Shares they held.

12. In May 2013, Mr Fearn held 2,732,500 A Shares and Mr Phelan held 2,679,600 A Shares. In total the company had 9,332,744 ordinary shares in issue and so it follows that the total nominal value of all shares was £933 and there were 3,920,644 25 B Shares in issue.

13. The costs of developing and marketing the Company's product were high. In the months up to May 2013, it became clear that the company would need to raise around £300,000 from its shareholders. The commercial arrangement was that neither Mr Fearn nor Mr Phelan would provide any of the funds required.

30 14. If the capital structure of the Company remained unchanged, and holders of B Shares simply subscribed for further B Shares, more than half of the amount that holders of B Shares subscribed would benefit the holders of the A Shares (since the A Shares ranked side by side with B Shares in economic terms). The holders of the B Shares were not prepared to make a further investment in the company in those 35 circumstances.

The 2013 Reorganisation

15. As a consequence of the point made at [14] above, the Company, Mr Phelan, Mr Fearn and their respective advisers decided that a reorganisation of the Company's capital was needed to enable it to obtain further investment from its shareholders.

16. The initial plan was that 900,000 of Mr Phelan's A Shares, and 600,000 of Mr Fearn's A Shares would be cancelled. That would reduce the amount of value that passed out of any investment made by holders of B Shares and, it was hoped, would enable the Company to secure the £300,000 that it needed by issuing further B Shares.

17. However, professional advisers noted that company law constraints made it, at the very least, difficult to implement this plan. The difficulty stemmed from the fact that the Company had no distributable reserves and that, accordingly, the Company could not repurchase 1.5m A Shares out of distributable reserves. While, as a private limited company, the Company might have been able to fund the repurchase out of capital, the directors of the Company would have needed to make a statement as to the solvency of the company in order to be able to do so. The Company's financial condition was not strong and it was felt that it might not be possible to make the requisite solvency statement. There was also some consideration of whether the A Shares could be repurchased out of the proceeds of a fresh issue of B Shares but that was felt not to be straightforward.

18. Therefore, it was determined that, instead of cancelling 1.5m A Shares, a similar result would be achieved by converting 1.5m A Shares into a new class of valueless non-voting Deferred Shares. All remaining A Shares and B Shares in existence would then become a single class of Ordinary Shares so that, following the reorganisation, the share capital of the Company would consist only of Ordinary Shares and Deferred Shares. Mr Fearn explained the proposal to shareholders in an email of 22 May 2013 in the following terms:

> • The share structure is being simplified so that all shareholders are equal.
>
> • 1,500,000 existing "A" shares are being converted into Deferred shares of no commercial value thereby reducing the share of the business held by the Founders.

19. The Shareholders in the Company agreed to the proposal and, to give effect to it, the Company adopted new Articles of Association (the "New Articles") by written resolution. Those revised Articles of Association included the following sections:

> **3. SHARE CAPITAL**
>
> The share capital of the Company on the date of adoption of these Articles is £1,084 divided into 9,332,744 Ordinary Shares and 1,500,000 Deferred Shares
>
> …
>
> **5 RIGHTS ATTACHING TO THE SHARES**
>
> On a return of assets on liquidation or otherwise, the assets of the Company available for distribution among the members shall be applied (i) first in paying to the holders of the Shares[1] a sum equal to the nominal amount of each Share held by them, (ii) secondly in

[1] Defined in Article 1.1 of the New Articles as meaning the Ordinary Shares

> paying the holders of the Deferred Shares a sum equal to the nominal amount of such Deferred Shares, and (iii) thirdly the balance of such assets (if any) shall be distributed amongst the holders of the Shares, pro rata (as nearly as may be) according to the nominal amounts paid up or credited as paid up on the Shares held by them respectively.
>
> Save for the return of the nominal value, the Deferred Shares shall not entitle the holders thereof to receive any assets of the Company on a return of assets on liquidation or otherwise.

20. Article 5.1.2 of the New Articles provided that dividends could be paid on the Ordinary Shares in the Company, but that the Deferred Shares carried no rights to dividends. Article 5.1.3 provided that each Ordinary Share carried one vote, but that the Deferred Shares carried no voting rights.

21. There was some doubt as to when the Company adopted the New Articles. HMRC understood that they were adopted on 22 May 2013. However, the set of the New Articles lodged at Companies House refers to those articles being adopted by written resolution passed on 13 June 2013. For reasons set out at [22] to [24], I consider that the 13 June 2013 is more likely to be the correct date.

22. The bundles of documents produced at the hearing included the text of a written resolution of the A Shareholders of the Company that was expressed to be "circulated to members" on 22 May 2013 and which dealt with the following matters:

> (1) Reclassifying 900,000 of Mr Phelan's A Shares, and 600,000 of Mr Fearn's A Shares as Deferred Shares;
>
> (2) Redesignating all remaining A Shares as Ordinary Shares with rights set out in the New Articles; and
>
> (3) Adopting the New Articles.

23. There was also a written resolution of B Shareholders of the Company, also expressed to be "circulated to members" on 22 May 2013, which redesignated B Shares as Ordinary Shares and adopted the New Articles.

24. The fact that these written resolutions were "circulated to members" on 22 May 2013 does not demonstrate that they were passed on 22 May 2013. On the contrary, since the Company had a number of members, it is to be expected that there would be some delay in arranging for all members who approved of the resolutions to sign them. I therefore consider it is more likely that these written resolutions were passed on 13 June 2013, the date that appears on the front of the New Articles.

25. The 2013 Reorganisation achieved the desired result and, on 8 July 2013, the Company successfully issued 1,657,000 Ordinary Shares for an aggregate consideration of £331,400, raising the funds that were considered necessary.

26. I am satisfied that the 2013 Reorganisation took place for entirely commercial reasons, namely to provide the Company with the funds that it needed to operate its business.

The preferential right attaching to the Ordinary Shares and its effect on the claim for EIS relief

27. The effect of Article 5 of the New Articles was to give the Ordinary Shares a preferential right to a return of assets of the Company on a liquidation or otherwise. That was because, on such a return of assets, Article 5 required holders of Ordinary Shares to receive the nominal capital on the Ordinary Shares before the holders of Deferred Shares received the nominal capital on their shares. Therefore, on a return of capital there was, as Mr Howard put it, a "sandwich" of rights:

(1) Firstly, the holders of the Ordinary Shares would receive the nominal value of those shares of £933.

(2) Secondly, the holders of the Deferred Shares would receive the nominal value of those shares of £150.

(3) Finally, the holders of the Ordinary Shares alone would participate in any remaining surplus.

28. On 6 August 2015, the Company submitted a Form EIS1 to HMRC. In that form (which was signed by Mr Fearn), the Company gave details of the issue of Ordinary Shares on 8 July 2013 and made a number of declarations. One of those declarations was to the effect that:

> "the shares listed at 1. above[2] … are ordinary shares which, at no time since they were issued, have carried any preferential rights to the company's assets on a winding-up…"

29. The Form EIS1 was a "compliance statement" under s205 of ITA 2007. By making such a "compliance statement", the Company was certifying to HMRC that the requirements necessary for EIS relief to be available for the issue of Ordinary Shares were satisfied. The hope and expectation, therefore, was that HMRC would respond with a Form EIS2, which would authorise the Company to issue a "compliance certificate" (Form EIS3) to its investors under s204 of ITA 2007 which would, in turn, enable investors to claim EIS relief in relation to the amount subscribed for their Ordinary Shares.

30. However, it soon became clear that there was a problem. As set out in more detail below, s173(2)(aa) of ITA 2007 provides that an issue of shares which at any time in a specified period after their issue "carry any present or future preferential right to a company's assets on its winding up" cannot benefit from EIS relief. On 21 August 2013, HMRC wrote to the Company's advisers setting out their view that the Ordinary Shares issued did carry such a preferential right given the provisions of the New Articles set out at [19].

31. Some correspondence ensued in which the Company sought to persuade HMRC that the Ordinary Shares did not carry a "preferential right". However, HMRC were

[2] I did not have the attachment to this form which would have made it clear whether this included a reference to Ordinary Shares only, or whether it also embraced the Deferred Shares. However, since it is clear that EIS relief could not have been available in relation to the issue of the Deferred Shares, nothing turns on this issue.

not persuaded and, on 30 September 2015, they made the two decisions referred to at [3] above which have resulted in the Company bringing this appeal.

The magnitude of the preferential right

32. Since one of Mr Howard's central submissions was that the preferential right attaching to the Ordinary Shares was *de minimis*, it is appropriate to set out some findings as to the magnitude of the preferential right.

33. The maximum amount that holders of Ordinary Shares could receive on a liquidation, or other return of capital, in preference to holders of Deferred Shares was £933, the total nominal capital of the Ordinary Shares. Looked at another way, the maximum total amount that the Company could pay on a liquidation, or other return of capital, to holders of Deferred Shares was £150.

34. The total share capital of the Company (including both nominal capital and share premium) was £2.44m immediately prior to the 2013 Reorganisation and £2.77m immediately after the 2013 Reorganisation (taking into account the new Ordinary Shares issued on 8 July 2013). There was no dispute that, following the 2013 Reorganisation, the total market value of all shares in the Company was around £2.2m.

35. Therefore, the maximum preference of £933 on the Ordinary Shares represented less than 0.05% of the market value of all shares in the Company and less than 0.04% of the total share capital (including share premium) of the Company following the 2013 Reorganisation. The total amount that could be paid on the Deferred Shares represented less than 0.01% of both the market value of all shares in the Company and the total share capital of the Company.

36. However, in terms purely of nominal capital, the Deferred Shares represented approximately 14% (i.e. £150 divided by £1,084) of the Company's total nominal capital.

Statutory provisions relevant to the appeal

37. Section 173 of ITA 2007 sets out the "shares requirement" that must be satisfied in relation to shares in relation to which EIS relief is claimed. Insofar as relevant, s173 provides as follows:

> **173 The shares requirement**
>
> (1) The relevant shares must meet the requirements of subsection (2)…
>
> (2) Shares meet the requirements of this subsection if they are ordinary shares which do not, at any time during period B carry …
>
> (aa) any present or future preferential right to a company's assets on its winding up.

38. Section 173 was amended in relation to shares issued on or after 6 April 2012 to deal with certain situations in which shares carry preferential rights to dividends.

Therefore, while the Ordinary Shares issued on 8 July 2013 (in relation to which HMRC are denying the ability to claim EIS relief) are dealt with by the "new" s173, certain of the shares issued prior to 6 April 2012 (in relation to which HMRC are seeking to claw back EIS relief previously given) are within the scope of the "old" s173. However, it was common ground that, since there was no question of any relevant shares carrying preferential rights to dividends, nothing turned on the distinction between the versions of s173 as in force at various times.

39. Section 159 of ITA 2007 provides that "Period B" begins with the issue of shares and ends immediately prior to the "termination date" for those shares.

40. Section 256 of ITA 2007 defines the "termination date". Typically, it is three years following the issue of the shares in question. However, where a company is raising money for the purposes of a trade which has not been commenced, the termination date can be extended to the three-year anniversary of commencement of the trade.

41. Section 203 of ITA 2007 provides that an individual can claim EIS relief in respect of an amount subscribed if that individual has received a "compliance certificate" from the issuing company in relation to those shares. Section 204 of ITA 2007 deals with compliance certificates. In particular, s204(2) provides that, before it can issue a compliance certificate to investors, the issuing company must first give HMRC a "compliance statement" (under s205 of ITA 2007) which gives details of the shares issued and confirms that the conditions of EIS relief set out in s157 of ITA 2007 (including that set out in s173) are satisfied. Moreover, s204(3) of ITA 2007 provides that a company cannot issue investors with a compliance certificate without the authority of HMRC.

42. Section 206 of ITA 2007 permits a company to appeal against the refusal of HMRC to authorise it to issue a compliance certificate. Therefore, it is clear that the Company has a right of appeal against HMRC's decision to refuse to authorise the issue of a compliance certificate in relation to the shares issued on 8 July 2013.

43. Section 234 of ITA 2007 requires HMRC to withdraw EIS relief that is subsequently found not to be due. There appeared to be no dispute between the parties that, if the Ordinary Shares issued on 8 July 2013 failed the requirements of s173(2)(aa) of ITA 2007, that would entitle HMRC to withdraw EIS relief granted in respect of previous share issues whose "termination date" for EIS purposes fell after 22 May 2013[3]. Those previous issues would have been of A Shares and/or B Shares (since it was only following the 2013 Reorganisation that the Company had a single undifferentiated class of Ordinary Shares). While I heard no argument on the point, I assumed that the parties were in agreement that, since A Shares and B Shares were converted into Ordinary Shares as part of the 2013 Reorganisation, any failure of the

[3] Given the findings I make as to the date on which the written resolutions referred to at [22] and [23] were passed, I suspect the relevant date for this purpose should be 13 June 2013, rather than 22 May 2013. However, the parties agreed that this would make no difference to the share issues in relation to which EIS relief could be withdrawn.

Ordinary Shares to satisfy the requirement of s173(2)(aa) could amount to a failure of the A Shares and B Shares to satisfy that requirement, noting that the conditions of s173 are forward-looking and need to be satisfied throughout a period beginning with the issue of those shares.

44. However, without having heard any submissions from the parties on the point, it seemed to me that, if HMRC wish to withdraw EIS relief granted in the past, they must issue an income tax assessment under s235 of ITA 2007 on the individual investors. It was not clear to me that the Company (as distinct from those investors) could bring an appeal against any such assessment.[4]

The submissions of the parties

Mr Howard's submissions on behalf of the Company

45. Mr Howard did not dispute that the Ordinary Shares carried a preferential right to assets on the Company's winding up. However, he submitted that, properly construed, this did not cause the requirement of s173(2)(aa) of ITA 2007 to be failed. I will not set out all of the submissions that he made, but the essence of them was that, when construing s173(2)(aa), the following principles of statutory construction had to be applied:

(1) Firstly, applying the principle of statutory construction known as the *Ramsay* principle, s173(2)(aa) had to be construed in a "purposive" manner having regard to the facts viewed realistically. The Ordinary Shares, he submitted, carried with them the overwhelming majority of the risk and reward in the Company's business and were the kind of shares that Parliament intended to benefit from EIS relief. Accordingly, in his submission, Parliament cannot have intended the insignificant preferential right on those shares to disqualify EIS relief.

(2) Secondly, he submitted that there was a general principle of statutory construction, known as the *de minimis* rule that should be applied as an aid to the construction of all UK statute law. That principle of construction, he submitted, was summed up by the Latin maxim "*de minimis non curat lex*" which the Supreme Court had translated as "too negligible for the law to be concerned about" in *R (on the application of Morge) v Hampshire County Council* [2011] 1 All ER 744 at [15]. He argued that the preferential right in this case fell within the scope of the provision either because the amount of the preferential right (£933) was itself *de minimis* or because the rights attaching to the Deferred Shares were so *de minimis* that the Deferred Shares could be ignored when determining whether the Ordinary Shares contained such a preferential right.

[4] A company does have a right of a appeal against a decision of HMRC to issue a notice under s234(3)(b) of ITA 2007 in connection with the withdrawal of EIS relief previously granted. However, in the circumstances of this appeal, where HMRC are asserting that the shares issued failed the conditions of s173(2)(aa) of ITA 2007, it does not appear as though HMRC are required to serve a notice under s234(3)(b).

(3) He emphasised that the Deferred Shares were not issued for any tax avoidance purpose but were part of a commercial arrangement that could not be achieved in a more straightforward manner because of the company law constraints referred to at [17].

5 46. Mr Howard derived support from sections 213 to 215 of ITA 2015. Section 213 provides for EIS relief to be withdrawn in certain circumstances where an investor receives value from the issuing company. However, s214 and s215 of ITA 2007 contain an exclusion for certain "receipts of insignificant value". Mr Howard accepted that these sections did not apply specifically to the situation under consideration but 10 contended that they were evidence that Parliament intended there to be a degree of latitude in the application of rules dealing with EIS relief.

47. Mr Howard referred us to extracts from a leading textbook, *Bennion on Statutory Construction*, in support of his arguments on the *de minimis* issue and submitted that *Customs and Excise Commissioners v J H Corbitt (Numismatists) Ltd* 15 [1980] STC 231 was authority for the *de minimis* principle being applied in a tax context.

48. Finally, Mr Howard referred to HMRC's published guidance set out in paragraph VCM12020 of their published manuals which stated as follows:

> The rights carried by ordinary shares may in some cases be preferential 20 as compared with the rights of deferred shares, but this is not necessarily so. In particular, where deferred shares carry a purely theoretical right to a residue of assets in a winding up (for example where, in the case of a very small company, after the first £20 million has been distributed to ordinary shareholders the deferred shareholders 25 are entitled to 1p per share), we do not regard the ordinary shares as carrying a preferential right.

He submitted that this was an accurate statement of the law and that HMRC should have applied that approach in this case.

Officer Foxwell's submissions

30 49. I will not set out all of Officer Foxwell's submissions, but, as with those of Mr Howard, will summarise the essence of them. He submitted that s173(2)(aa) of ITA 2007 drew a "bright line" between shares that could benefit from EIS relief and shares that could not. Given the clear Parliamentary language used, he submitted that HMRC had no discretion to apply a different approach and that, in any event, this Tribunal 35 had no jurisdiction to interfere with HMRC's decision not to exercise any discretion they might have.

50. He drew the opposite conclusion from Mr Howard as to indications that could be gleaned from sections 213 to 215 of ITA 2007. Officer Foxwell submitted that these sections demonstrated that, where Parliament intended, in Part 5 of ITA 2007, 40 for small or insignificant matters to be overlooked it legislated specifically to do so. Therefore, Officer Foxwell submitted that Parliament's failure to exclude small or

insignificant matters in s173(2)(aa) demonstrated that it did not intend any *de minimis* exclusion to apply for the purposes of that section.

51. He submitted that the extracts from HMRC's guidance could not assist the Company since they simply set out HMRC's view of the law and were directed at a different situation.

52. Finally, he submitted that the preferential right attaching to the Ordinary Shares was not minor or insignificant given that the Deferred Shares represented some 14% of the Company's issued capital in terms of nominal value.

Discussion

53. Officer Foxwell suggested that the Company was requiring HMRC to exercise a discretion in its favour. I do not agree that this was the effect of Mr Howard's submissions. I took Mr Howard to be submitting that the Ordinary Shares met the condition set out in s173(2)(aa) of ITA 2007 so that HMRC were <u>bound</u> to grant EIS relief on those shares. I therefore consider that the point at issue in this appeal involves the true construction of s173(2)(aa) and, in approaching this task, I have taken into account the guidance that Ribeiro PJ gave on the approach to the construction of taxing statutes in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 where he said, at [35]:

> The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.

54. I am prepared to accept that the *de minimis* principle can, in appropriate situations, apply as an aid to the construction of a taxing statute just as much as it can aid the construction of any other statute. However, the *de minimis* principle has to yield to any contrary intention, as the extracts from *Bennion* to which Mr Howard referred themselves made clear.

55. Therefore, the ultimate question, whether phrased in terms of the *Ramsay* approach to statutory construction, or the application of the *de minimis* principle, is whether Parliament intended the Ordinary Shares issued on 8 July 2013 to satisfy the condition set out in s173(2)(aa) even though they carried some, albeit small, preferential rights to a return of capital on a winding up. For the reasons set out below, I have concluded that Parliament did not intend small or insignificant preferential rights to be ignored when applying s173(2)(aa). I therefore accept the core of Officer Foxwell's argument to the effect that s173(2)(aa) imposes a "bright line" test.

56. The first point that I have taken into account in construing s173(2)(aa) is that Part 5 of ITA 2007 (in which s173(2)(aa) is located) is lengthy, running to some 45 pages in Tolley's Yellow Tax Handbook. Part 5 sets out a number of detailed conditions that the investor, the company being invested in, and the shares issued must satisfy. These conditions in many cases themselves contain qualifications and exceptions. Lord Millett acknowledged in his judgment in *Arrowtown* that the words

of a particular statute may be too "closely articulated" to admit the *Ramsay* principle to apply as an aid to its construction and I have no doubt that Part 5 is a "closely articulated" set of statutory provisions.

57. The fact that Part 5, as a whole, is a closely articulated set of provisions has led me to conclude that, if Parliament had intended small or insignificant preferential rights to be ignored in applying s173(2)(aa), they would have made express provision to this effect. The provisions of sections 213 to 215 of ITA 2007 demonstrate that, in particular cases, Parliament has turned its mind to situations where small or insignificant matters should be ignored. That no such provision has been made in s173(2)(aa) suggests that they intended any preferential right (whether small or not) to be taken into account when applying that section.

58. Mr Howard submitted that the approach outlined at [57] would deprive the *de minimis* principle of any effect since the whole essence of that principle is that it can apply even where Parliament has chosen not to make specific provision. I do not accept that submission. If I were deciding that the *de minimis* is incapable of application in any circumstances in which Parliament has not made specific provision, that would indeed deprive the maxim of effect. However, I am not deciding that. I am simply concluding that, if Parliament has not made specific provision in a "closely articulated" statutory regime such as Part 5 of ITA 2007, that is evidence of the necessary "contrary intention" that would prevent the *de minimis* principle from applying.

59. I also consider that some inferences can be drawn from the statutory procedure that must be followed in order to enable an investor to claim relief. As noted at [41], before a company can issue a certificate of compliance, it must first certify to HMRC that all of the conditions of EIS relief (including that in s173(2)(aa)) are satisfied. Parliament, therefore, requires a company to make a formal declaration to HMRC that the shares being issued do not carry any preferential rights to assets on a winding-up. While lawyers may be aware of the existence of the *de minimis* principle, I doubt that directors of companies of the kind that can benefit from EIS relief (which are, by definition, relatively small) would be aware of it. Therefore, if Parliament had truly intended that a company could properly make a compliance statement even if the shares being issued carried some, albeit small, preferential rights there is a further reason why they would have said so expressly.

60. In support of his submissions on "purposive construction", Mr Howard submitted that the evident purpose of the statute was to give EIS relief in situations where individuals are subscribing for shares that carry "genuine economic risk". Since the small preferential right attaching to the Ordinary Shares did not in any significant respect alter their participation in the risk associated with the Company's business, he submitted that a "purposive" construction of the statute should lead to a conclusion that relief is available. As was made clear in *Barclays Mercantile Business Finance v Mawson* [2004] UKHL 51, the "purpose" of a statutory provision has to be determined from the words of the statute concerned. Mr Howard's submission as to the "purpose" of the statute amounts to him assuming what he is seeking to prove. Given the words of the statute used, I consider it is more accurate to say that

Parliament intends relief to be available in connection with shares that carry “genuine economic risk” only where those shares do not also carry any preferential right to assets on a winding up.

61. Finally, I do not consider that the extracts from HMRC’s published manuals referred to at [48] affect the matter. Firstly, as Officer Foxwell noted, those extracts set out HMRC’s view of the law rather than principles of law that are binding either on HMRC or the Tribunal. In any event, they seem to be aimed at a completely different situation, namely the situation where the rights of a deferred share to share in assets on a winding are so contingent as not to be meaningful. While the preferential right in this appeal is certainly small, it is definitely not contingent and it would apply on any winding-up of the Company.

62. It follows, therefore, that I have not accepted Mr Howard’s central submission that the preferential right attaching to the Ordinary Shares can be ignored provided it is small.

63. In those circumstances, I do not need to consider whether the preferential right is actually sufficiently small to be ignored. However, for the sake of completeness, I record my view that, if there were scope for small preferential rights to be ignored, the preferential right attaching to the Ordinary Shares would be sufficiently small to be ignored. I am not prepared to accept Mr Howard’s submission that, because the rights attaching to the Deferred Shares were insignificant, the Deferred Shares should be completely ignored in determining whether the Ordinary Shares meet the condition in s173(2)(aa) of ITA 2007. The Deferred Shares were real shares that fulfilled a genuine commercial purpose as they were the mechanism by which the 1.5m A Shares ceased to carry any meaningful economic rights even though company law constraints made it difficult to cancel or repurchase those shares. However, the preference attaching to the Ordinary Shares represented just £933 out of a total issued share capital of over £2.2m. I consider that can be described as a *de minimis* preference as it is small in both absolute terms and as a percentage of issued share capital. I do not consider that the fact that the Deferred Shares represent more than 14% of nominal capital alters that conclusion. Section 173(2)(aa) directs attention at the existence or otherwise of a preferential right that is carried by the Ordinary Shares. Therefore, I consider it follows that any question as to whether that preferential right is *de minimis* needs to be addressed by examining the magnitude of that right and not the nominal value of a class of shares other than the Ordinary Shares.

Conclusion

64. The Company’s appeal against HMRC’s refusal to authorise the issue of a compliance certificate in relation to the Ordinary Shares issued on 8 July 2013 is dismissed.

65. I do not consider that the Company has standing to appeal against the decision referred to at [3(2)] and I dismiss the appeal for that reason. Even if the Company does have standing to appeal that decision, given the parties’ evident agreement

referred to at [43], I consider that the decision I have made at [64] means that this aspect of the Company's appeal would fail as well.

66. The appeal is, accordingly, dismissed.

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.

JONATHAN RICHARDS

TRIBUNAL JUDGE
RELEASE DATE: 6 NOVEMBER 2015