TC01423

Appeal number: TC2010/05526
TC/2010/05527

Claim for loss relief – section 574 Income and Corporation taxes Act 1988 – was money provided for shares – company records not produced – no share certificate produced - company in liquidation – no convincing evidence of subscription for shares – no prior dealings to support an implied agreement with the company to issue shares - appeal dismissed

FIRST-TIER TRIBUNAL

TAX

MR JOHN HALNAN and MR MATHEW SQUIRE **Appellant**

- and -

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

TRIBUNAL: JUDITH POWELL (TRIBUNAL JUDGE)
H GARETH JONES MBE JP - MEMBER

Sitting in public at Holborn Bars, 138-142 Holborn London EC1N 2NQ on 15 February 2011.

Mr Jonathon Hawkes, Brackman Chopra LLP representing the Appellants.

Mrs H Leithes-Wilson and Mrs N Parslow instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents.

DECISION

Appeal

1. This is an appeal by each Appellant against closure notices issued to each of them at the end of an enquiry into their respective returns for the period ending on 5 April 2005. Each notice contained a decision disallowing a claim for an allowable loss in the year 2004-05 under section 574 Income and Corporation Taxes Act 1988 (TA 1988). The facts and matters at issue are identical for each Appellant and, following a direction made on 21 July 2010 the appeals proceed together and will be heard at the same time. The matters at issue are whether the Appellants purchased shares in The Media Cell Ltd ("the Company") a close company of which they were both directors and whether they are entitled to claim loss relief under section 574 TA 1988.

Facts not in dispute

2. The Appellants were both directors of the Company for the period 18 March 1998 to 31 October 2004. The company was a close company, incorporated in the UK and carried on its business wholly or mainly in the UK from the time it was incorporated. The company ceased to trade on 31 October 2004 and a liquidator was appointed and the Company was dissolved on 3 July 2007. Each of the Appellants provided £50,000 to the Company in May 2004 but have been unable to produce share certificates and there are no contemporaneous notes of the meeting in which the share purchase said to be discussed, agreed and allocated to them and there is no record of such a share purchase at Company's House and the directors have been unable to produce the Company's register of members. Both Appellants have claimed a loss in the year ended 5 April 2005 under section 574 TA 1988 and have claimed repayment of tax. Enquiries into the relevant tax returns were opened on 17 November 2006 for Mr Squire and closed on 29 January 2009 and opened on 18 September 2006 for Mr Halnan and closed on 9 February 2009; in both cases the loss relief claimed was disallowed. Both Appellants appealed against the closure notices on 10 February 2009.

Facts in dispute

3. The Appellants say that they each paid £50,000 to the Company for the acquisition of shares in the Company and that this was agreed at a meeting on 1 May 2004 where both Appellants were present together with a consultant to the Company, a Mr Peter Lawrence. They say that the affairs of a small private company are often conducted informally and the absence of related share certificates and other evidence of shares being issued to them as would normally exist where a larger company is involved is not fatal to their argument. The Respondents say there is no evidence that they had subscribed for shares as required by section 574 TA 1988 since although it was accepted they had each paid consideration of £50,000 to the Company it was disputed that shares had been issued to them given that no share certificate had been

issued and there was no evidence of actual allotment, notification and entry in the register of members..

Evidence

4. We were shown a signed statement of Mr Peter Lawrence who had attended the meeting of the Company on 1 May 2004 at which the Appellants say they agreed to acquire the shares in question. We did not hear any oral evidence and so we were unable to establish anything further about what occurred at the meeting on 1 May 2004. We were given a joint bundle by the parties and were taken through this bundle both by Mr Hawkes and by Mrs Leithes-Wilson.

Facts found

5. The letter from Mr. Lawrence did not contain a very clear account of the meeting held on 1 May 2004. Perhaps this is unsurprising since it was written on 25 August 2007 – more than three years after the meeting took place. It records that two of the three directors (Mr Halnan and Mr Squires) were present and refers to the Company's need for £250,000 long term funding. It records that each director resolved to subscribe for £50,000 additional shares in the Company but, confusingly the letter goes on to record that subsequent to the meeting "Mr Halnan and Mr Squire discussed the resolutions with the Mr Redmond and sought his agreement". Mr Redmond was the third director and so it is plain he could not have agreed to subscribe for further shares at the May 1 meeting. Mr Lawrence's letter also records that Mr Redmond was unable to provide additional funds to the Company so that only the two directors present at the meeting provided £50,000 each. There is no dispute that they did subsequently pay these sums to the Company. We accept that the discussion at the meeting of Mr. Halnan and Mr Squires contemplated a subscription of shares but because Mr Lawrence's letter is a confusing record of that meeting all we can find from that letter is that a subscription for shares was discussed but not that any binding agreement to subscribe was reached; clearly the two directors present were unable to commit Mr Redmond to subscribe but it is equally unclear whether they reached a binding agreement with the Company to do so themselves. We accept that they did provide a further £50,000 each to the Company and may well have left the meeting willing to do so whether or not Mr Redmond was willing and able to provide £50,000 as well but that falls short of us being able to find from the letter alone that there was a binding agreement between the Company and the two directors to do so. It seems that the Respondents accepted in a letter written on 11 October 2007 by Mr Willett to Messrs Brockman Chopra LLP and based on this letter from Mr. Lawrence that each of the Appellants paid the money "by way of subscription for the intended acquisition of a further 50,000 shares" but this was not one of the agreed facts and we think it was a generous interpretation of the letter we were shown.

6. Unsurprisingly we were not shown any documents to support the formal issue of the shares. The records at Companies House show that the original share holding of the Company at incorporation was one £1 share held by each of the three directors.

We were referred to a Statement of Affairs of the Company on 20 December 2004 as part of the liquidation process that had by then been commenced. This Statement was sworn by Mr Halnan and the pages exhibited were said to be "to the best of my knowledge and belief a full true and complete statement of affairs of the Company at 20/12/2004". This Statement recorded the paid up share capital as £3. We accept that the Liquidator could only record what was formally shown at Companies House but we note that another exhibit showed each of the three directors as creditors owed £104,848 (Mr Halnan) £15,932 (Mr Redmond) and £108,241 (Mr Squires) which the Appellants accept included the £50,000 provided by each of them to the Company. The Directors Report at the meeting of creditors on 20 December 2004 and chaired by Mr Halnan states that "The Board of Directors comprises of Richard Redmond, Matthew Squire and John Halnan who hold an equal shareholding of 1 share each" and also stated that "in early 2004 Matthew Squire and John Halnan injected £32,000 into [the Company] which was repayable over three years, in addition in May 2004 a further £100,000 of finance was placed into [the Company] by Matthew Squire and John Halnan". The Report stated that the directors had agreed the content of and consented to the issue of the report. There was a reference to the lack of access to the Company's accounting records. There was a caveat that "certain figures will be subject to clarification by the liquidator" and an earlier statement that the amount of directors' loan accounts were subject to confirmation.

7. The original £10,000 authorised share capital was unchanged for the year ended March 31 2003 and the Company's Register was not available to be inspected.

Submissions

8. It was submitted for the Appellants that they had paid money into the Company and this should be treated as a "subscription" on the basis that the Company had an obligation to issue shares. They say that the condition for relief is satisfied if the Appellants subscribed for shares and that references to an issue of shares in section 574(3) (a) do not impose a further requirement that the shares should be "issued" but even if that is not correct the shares were issued for the purposes of this relief and in the context of this company.

9. The Company was a small close company. Matters were dealt with on an informal basis. The Appellants were directors and Mr Squire was Company Secretary. The last Return pre dated the £50,000 payments to the Company. The Directors Report describes the early 2004 provision of funds (which it is accepted was by way of loans) differently from the May 2004 payments and in particular the first payments in 2004 were described as having repayment provisions attached to them but the later payments were not so described. The Appellants through Messrs Brockman Chopra LLP asked the joint liquidators for share certificates in 2005 and in 2006 and the Appellants say it is telling that the liquidators did not say in response that the Appellants were not entitled to them but merely that they were unable to issue them and they also stated that they did not have statutory books and records.

10. The Appellants say that the case of *National Westminster Bank plc v Commissioners of Inland Revenue* 67 TC 1 relied upon by the Respondents as describing what is necessary for shares to be issued is relevant to a public company where the issue date is the relevant matter and not to a small private company where the question is whether there was a subscription or, possibly, an issue, rather than the precise date of issue and that dissenting judgements in NatWest and the case of *Blackburn and another v Revenue and Customs Commissioners* [2009] STC 188 are both more helpful and more relevant in the present situation whilst recognising that the case of Blackburn is not on all fours with this situation.

11. It is relevant to note here that the Blackburn case also involved a consideration of the meaning of "issue" although it was in the context of EIS relief being claimed. Relief in that case depended upon the taxpayer having subscribed in cash for the issue of shares as well as not having been repaid a debt by the company; the question was the effect of the Taxpayer having paid money to the company prior to the company's resolution to allot the shares to him and whether a debt was incurred at the time the money was paid to the company. In that case the taxpayer had paid money to the company on a number of occasions – on some occasions the company had resolved to allot shares before the taxpayer paid over the money but on two occasions some was paid before and some was paid after the resolution to allot and on another the payments were all made prior to the resolution to allot. The Court of Appeal considered the status of those payments which were made in whole or in part before the application for shares and the company's decision to allot them had been made. In dismissing the Revenue's appeal in relation to two of the payments Lord Neuberger said at 196 *"I consider that the proper characterisation of the arrangement was that the £96,000 was paid by Mr Blackburn to the company and accepted and spent by the company on the clear mutual understanding, indeed implied agreement, that the company would allot 96,000 shares to him"* and later on that same page *" It was suggested that a limited company cannot effectively accept capital contributions other than in the form of loan capital or share capital. Even if that suggestion was, in general, correct, I cannot accept that it would extend so as to prevent a company from accepting and holding money on the basis that it is bound (or at least entitled) as against the payer to allot shares to him in return for the payment (with the possibility of having to repay the money if the shares are not then allotted).*"

12. The Appellants say that provisions of section 574(3) which apparently impose an obligation for shares to be "issued" as a pre condition to relief being available under section 574 are intended to impose a restriction limiting the relief to situations where value has been provided for the share issue rather than containing an exhaustive definition of the word "subscribe" and that the Appellants did subscribe for shares because the Company had an obligation to issue them. They say that because the loss is based on capital gains tax principles it is relevant to look at the statutory provisions dealing with that tax and referred to section 288(5) of the Taxation of Chargeable Gains Act 1992 which provides that "shares…. comprised in any letter of allotment or similar instrument shall be treated as issued unless the right to the shares ….remains provisional until accepted and there has been no acceptance" although we were not referred to any "similar instrument" and in later submissions it was accepted that there was no document of title. Finally they submitted that there has been an issue of

shares when title to them is complete and that whilst this is normally when those shares are registered in the Membership register it may not be limited to that situation and that the Company was under an obligation to issue shares and although there was no documentary evidence of title there was evidence of the Company's obligation in the form of the letter from Mr. Lawrence and this is sufficient to support a conclusion that shares were both subscribed for and issued that the closure notices should be amended to show a capital loss available to set against income as contemplated by section 574 TA 1988.

13. The submissions for the Respondents are as follows. They say that the Appellants need to demonstrate that shares had been issued to them and they had failed to do so. They say that because the word "issue" is not defined by statute reference must be made to case law to establish exactly what constitutes the issue of shares for tax purposes; they refer to *National Westminster Bank plc v Commissioners of Inland Revenue* 67 TC 1 for guidance as to the meaning. (In that case the assertion that shares are not issued until they are registered was disputed and it was the date of "issue" that was relevant.) In particular they refer to the judgement of Lord Templeman on page 31 at paragraph H "*In my opinion, shares are issued when an application has been followed by allotment and notification and completed by entry on the register. Once the shares have been issued, the shareholder is entitled to a share certificate. The certificate declares to all the world that the person who is named in it is the registered holder of certain shares in the company and the shares are paid up to the extent therein mentioned*". They also referred to the judgement of Lord Slynn on page 47 at E where he said "*I do not consider that the shares in the present case were "issued" on "allotment": they were not issued until registration took place.*" In commenting on the submission for the Appellants that the following words of Lord Jauncey in his dissenting judgement *"I am satisfied that the word "issued" in s.289(1) and 299A(1) did not require the registration of shares to which it applied"* they pointed out that these words were preceded by the comment "*if he can do this satisfactorily without relying on registration*" (the word "this" referring to the taxpayer being able to show that he is "fully committed to share in the fate of" the company concerned) and they say the Appellants have not shown this.

14. The burden of proof in this case falls on the Appellants. The Respondents say that the Appellants are unable to provide any documentary evidence supporting an issue of shares. They do not dispute the Appellants made an investment of £50,000 each in the Company in May 2004, they do not seem to dispute that the Appellants intended to subscribe for shares when they paid the money to the Company nor that the Company was a qualifying company for section 574 TA 1988 purposes but they dispute that the Appellants subscribed for shares for the purposes of section 574 TA 1988. They say there is no evidence to support this. They point to a discrepancy in the letter written by Mr Lawrence concerning the resolution referring to three directors whilst also stating that only two directors were present and whilst they accept the Appellants intended to subscribe they say they never carried through with that intention. They say in relation to the Appellant's references to the Blackburn case that the prior dealings which existed in that case did not exist in the present case and if there is some evidence of prior dealings it supports that the finance was provided by way of loan rather than share capital and that there was no transaction

involving the issue of shares that might be regarded as similar and the only previous occasion when shares were issued by the Company was when the original shares were allotted many years earlier. They make the point that in finding that the first payment in the series of payments under appeal in the case of Blackburn did not qualify for relief Lord Neuberger based his judgement on the fact that the taxpayer was unable to point to any course of dealing or an understanding of the need for shares to be allotted to him to achieve his purpose and this was to be distinguished from the later payments in the series.

The Statutory provision for relief

15. Section 574(1) TA 1988 contains provisions for relief from income tax "Where an individual who has subscribed for shares in a qualifying trading company incurs an allowable loss (for capital gains tax purposes) on the disposal of the shares in any year of assessment". There is no dispute that the claim was made within the necessary time limits; it is also agreed that if the individuals had subscribed for shares and those shares had become of negligible value then upon a claim to that effect there would be a deemed disposal of those shares for the purposes of calculating whether an allowable loss had been realised. Section 574(3) (a) TA 1988 provides that "an individual subscribes for shares if they are issued to him by the company in consideration of money or money's worth".

Our decision

16. Unfortunately this is a case where it was difficult to form a clear picture of the events surrounding the May 2004 meeting or of the subsequent events leading up to the payment of funds to the Company which it received on 7 May 2004. We accept this was a small company; moreover it was a company in financial difficulties. We can see that a degree of informality is to be expected compared with, say, the company whose shares were relevant in the Natwest case. We were not entirely sure whether the Respondents took the view that unless shares were registered in the names of the Appellants they could not qualify for relief but that is not important in view of the decision we have reached.

17. In early correspondence with the Appellants' agent the officer dealing with the claim accepted that based on the letter from Mr. Lawrence the payment was by way of subscription for the *intended* acquisition of shares. Certainly Mr Lawrence's letter recorded that the three directors agreed that they would each subscribe for £50,000 additional shares in the Company but we have already seen that this record is flawed since only two of the directors were present. We were unable to attach a great deal of weight to the matters in that letter even if we ignored the obvious inconsistencies. Even if the letter from Mr Lawrence shows that the Appellants made payment with the intention of subscribing for shares this does not amount to the implied understanding or clear mutual agreement with the Company referred to by Lord Neuberger in Blackburn and the remaining documents shown to us certainly did not further support the Appellants' submissions.

18. We can accept (as the Respondents seem to have done) that the Company secretary fell behind with the paperwork but we note that the secretary was one of the Appellants and if the acquisition of shares had been perceived by him to be of importance it is strange that he did not attend to the issue of the shares for which he and his fellow director had subscribed. It is possible that there is an explanation for this but if there was we did not hear it.

19. The Statement of company affairs and the exhibits may have been prepared by the liquidators but one of the Directors gave a signed statement as to their accuracy. If it had been of significance to him that he had subscribed for shares we would have expected him to query the statement showing that he had lent the moneys to the Company and if he did not appreciate its significance it is difficult for him to advance a successful argument that there was an implied understanding with the Company that shares would be allotted to him. Again we did not hear any explanation from him to explain why he did not query this with the liquidator - maybe he did do so and was told that it was not possible to reflect the payments differently (there was a suggestion from Mr Hawkes that this was the case) but if he had such a conversation we were not told of it.

20. The argument that shares were issued upon payment to the company succeeded in the Blackburn case because it was found there was an implied understanding or clear mutual agreement that the payment by the taxpayer was on condition that the company would issue shares to him. The argument succeeded in the Blackburn case not only because of a prior course of dealing (which did not exist in this case) but also because the taxpayer understood the importance that the payment should be made for shares as a result of advice he had received from his accountant. There is no such evidence here. The payment made in Blackburn before there was a history of prior dealings and before he had spoken to his accountant to take advice how the payment should be structured was not held to be eligible for relief and the payments in this case have a similar profile.

21. We considered the Appellant's argument that the purpose of section 574(3)(a) is to limit shares which can qualify for relief to those which have been issued for the consideration mentioned in that sub section and that it does not impose a general requirement that shares must be issued and that section 574(1) refers only to the taxpayer subscribing for shares. However, the Appellants acknowledged that shares would only be subscribed for in a section 574 sense if the Company had an obligation to issue them as a result of receiving the payments. The letter from Mr Lawrence records only what happened at the May 1 2004 meeting and at the most this is evidence only of what two of the directors intended at that time and not that they had also reached a clear understanding with the Company. Although they were also directors of the Company there is no suggestion that they left that meeting committed to provide funds to the Company nor that the Company was bound, upon receiving payment, to issue shares to them since further matters remained to be resolved including the position of the third director and the raising of the further funds required from third parties. For these reasons we dismiss the appeal of both Appellants.

22. 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.

TRIBUNAL JUDGE:

RELEASE DATE: 7 SEPTEMBER 2011