TC02400

Appeal number: TC/2011/04483

INCOME TAX – loss relief – shares – s 574 ICTA 1988 – money held in director's loan account – board resolution to allot shares – company secretary instructed to prepare and issue share certificate and to enter allotment in shareholders' register – due to external circumstances, latter actions not taken – whether shares issued to director – held, on facts, no – whether, on assumption that shares issued, any loss incurred on shares – whether value had become negligible – held that no evidence of any change of value of shares between board meeting and resolution to wind up company – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

PETER SAUND **Appellant**

- and -

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

TRIBUNAL: JUDGE JOHN CLARK
JACQUI DIXON

Sitting in public at Southampton on 31 October 2012

Douglas Abbott, accountant and investment adviser, for the Appellant

Darren Bradley, Officer of HM Revenue and Customs, for the Respondents

DECISION

1. Dr Saund appeals against an amendment to his 2006-07 self assessment return, made by a closure notice dated 21 January 2011, refusing relief claimed for a loss under s 574 of the Income and Corporation Taxes Act 1988 ("ICTA 1988").

The background facts

2. The evidence consisted of a bundle of documents; Dr Saund gave oral evidence. In addition, Mr Abbott provided information in the course of presenting Dr Saund's case; although this did not amount to evidence as such, Mr Bradley did not seek to challenge the information provided. We have therefore accepted that this information should be taken into account, but on the basis that it does not have the same weight as formal evidence.

3. From the evidence and from the information provided by Mr Abbott we find the following background facts.

4. Dr Saund, a dentist, was approached in 2004 by members of his wife's family with a proposal for him to make an investment in Langbourne College Ltd ("LCL"), of which they were to be managers. Without giving particularly thorough thought to the proposal, he agreed to make an investment in LCL. LCL was incorporated on 19 May 2004; on the same date, Dr Saund was appointed as the only director. His wife was the only shareholder, holding one share; she was also the company secretary. We understand from Mr Abbott that Dr Saund entered into some form of investment agreement; as this was not included in the evidence, we are unable to make any findings relating to it.

5. It was made clear at the outset that Dr Saund would have no input into the business of LCL as a language college, of which he had no knowledge or interest. He was running his own full time dental practice. LCL began to trade in April 2005. Dr Saund did visit the College once a week for a few times and felt that there was progress with its development; to him as a layman it looked like a happy place. He felt that he was part of the LCL business.

6. Until 12 January 2007, he continued to be under the impression that LCL was operating according to plan. For the first two years, LCL made losses. By 2007, he expected LCL to "break even"; in 2006 it had achieved recognition by the British Council. He was the sole source of LCL's financial support.

7. However, by January 2007 he became very concerned that information about LCL's business was not being supplemented by financial information. At that stage, matters were brought to a head, as financial information was not forthcoming. He discovered that bills were not being paid. He took advice from his accountants, who recommended that he should withdraw from providing financial support to LCL.

8. On 12 January 2007, a meeting was held of the board of directors of LCL. For the purposes of this decision, we find it necessary to set out the major part of the minutes of that meeting:

> "Re-organisation of the Company
>
> The Chairman [ie Dr Saund] outlined the state of the Company and recommended that radical proposals were necessary to deal with the Company's outstanding obligations.
>
> In particular, it was noted that the Chairman has provided temporary financial support to the Company in the sum of £850,000 to date, and that the Company had issued no formal acknowledgment of indebtedness.
>
> Mr Clements said he had received informal advice from a colleague - a qualified accountant specialising in small and medium-sized businesses - who had suggested that it might be easier for the Company to deal with its bankers if the Company's main creditor (i.e. the Chairman) took appropriate action to reduce the level of debt.
>
> In response the Chairman proposed that he subscribe for 99 new ordinary shares at a premium of £7,499 per share at a total consideration of £742,500, to be satisfied by the conversion of £742,500 of the outstanding indebtedness. After the issue of new shares, the Chairman would become the holder of not less than 99% of the Company's enlarged share capital.
>
> This action would remove a substantial current liability from the Company and properly reflected the level of risk that the Chairman was taking.
>
> Response of shareholders
>
> The sole shareholder present at the meeting agreed that the action proposed by the board was necessary and that the terms offered to the Chairman were reasonable.
>
> The Secretary was instructed to prepare and issue a share certificate to the new shareholder and to enter the allotment in the shareholders' register."

9. For reasons referred to later in this decision, the latter actions were not taken. On 19 January 2007 all LCL's staff were made redundant, and LCL ceased to trade on that date. On 29 January 2007 LCL instructed Wilson Field to convene a meeting of members and creditors to place LCL into creditors' voluntary liquidation. Notice of the meeting of creditors was despatched on 9 February 2007. On 20 February 2007 the first meeting of creditors of LCL was held. A Statement of Affairs of LCL was produced, and a resolution passed for the winding up of LCL. LCL was finally dissolved on 8 August 2009.

10. In his self assessment return for 2006-07, Dr Saund claimed relief for £386,596 of a loss of £742,500 in respect of what were described as "subscribed" shares in LCL; he also sought relief against his income for 2005-06 for £245,052 of that loss.

(As no action has yet been taken by the Respondents, "HMRC", in respect of 2005-06, that year is not covered by Dr Saund's appeal, which relates only to 2006-07).

11. On 25 July 2008, HMRC issued to Dr Saund a notice under s 9A of the Taxes Management Act 1970 ("TMA 1970") of their intention to enquire into an aspect of his 2006-07 return. HMRC asked his accountants for certain information in connection with his claim under s 574 ICTA 1988.

12. Correspondence continued from 28 August 2008 onwards between Dr Saund's accountants (Taylor Roberts, with whom we understand that Mr Abbott was not associated) and HMRC. (As the subject matter of the correspondence consisted largely of arguments considered at the hearing, we do not find it necessary to set out in detail the points considered in the course of the exchanges.) Following the issue of HMRC's closure notice and accompanying letter on 21 January 2011, it is apparent from later letters from HMRC that Dr Saund's accountants wrote an appeal letter (not included in the evidence bundle). On 21 March 2011 HMRC wrote to Dr Saund to state that their views remained unchanged, and indicated that if their decision could not be accepted, they offered a review, or the appeal could be notified to a tribunal.

13. On 10 June 2011, Dr Saund's accountants gave Notice of Appeal to HM Courts & Tribunals Service ("HMC&TS"). As the appeal was notified late, we consider this below.

The law

14. Section 574 ICTA 1988, as it applied for 2006-07, provided:

> "**574 Relief for individuals**
>
> (1) 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, he may, by notice given within twelve months from the 31st January next following that year, make a claim for relief from income tax on—
>
> (a) so much of his income for that year as is equal to the amount of the loss or, where it is less than that amount, the whole of that income; or
>
> (b) so much of his income for the last preceding year as is equal to that amount or, where it is less than that amount, the whole of that income;
>
> but relief shall not be given for the loss or the same part of the loss both under paragraph (a) and under paragraph (b) above.
>
> Where such relief is given in respect of the loss or any part of it, no deduction shall be made in respect of the loss or (as the case may be) that part under the 1992 Act.
>
> (2) Any relief claimed under paragraph (a) of subsection (1) above in respect of any income shall be given in priority to any relief claimed in respect of that income under paragraph (b) of that subsection; and any

relief claimed under either paragraph in respect of any income shall be given in priority to any relief claimed in respect of that income under section 380 or 381.

(3) For the purposes of this section—

(a) an individual subscribes for shares if they are issued to him by the company in consideration of money or money's worth; and

(b) an individual shall be treated as having subscribed for shares if his spouse or civil partner did so and transferred them to him by a transaction inter vivos."

Arguments for Dr Saund

15. Mr Abbott submitted that Dr Saund had subscribed for 99 shares, at a substantial premium. It was accepted that the time scale was very short between LCL appearing to be in an acceptable financial position and Dr Saund withdrawing his support. He had suffered a substantial loss, and made a claim for relief for that loss. The loss should be allowed against Dr Saund's income.

16. Mr Abbott acknowledged HMRC's argument that the shares had not been issued, not having been entered on the register of shareholders of LCL. However, there had been circumstances which had meant that there was no time to deal with this before LCL went into what he described as administration. (The relevant circumstances are considered below.) Mr Abbott emphasised that the transaction did take place on 12 January 2007 and the meeting had taken place; LCL had accepted the proposal.

17. The second issue raised by HMRC was that the shares were already of negligible value at the time of the 12 January meeting. There was a problem with valuing start-up companies; the normal "willing buyer, willing seller" test was difficult to apply. A company in that position could not demonstrate value on an earnings basis. However, LCL did enjoy the benefit of Dr Saund's financial support; it was only the withdrawal of that support which had caused LCL's value to become negligible.

18. Mr Abbott submitted that advice had been given to Dr Saund in advance and that the procedure at the meeting of LCL had followed the draft minutes; Dr Saund had been the only member of the board present, and therefore there had been no scope for misunderstanding.

19. Mr Abbott referred to substantial changes which were being made at the time to the subscription procedure; the Companies Act 2006 followed what had already been existing practice.

20. Dr Saund had been vulnerable and at all times had been taking advice. However, no professional adviser had been with him at the time of the preparation of to Statement of Affairs in respect of LCL. If an adviser had been present, it would have been noticed that there was no reference to Dr Saund's shareholding, and that he was shown as a creditor in respect of the funds provided from his director's loan

account. Mr Abbott had advised Dr Saund to write to the liquidators, and a response had been received to the effect that a letter could be produced but that there was no purpose in altering the Statement of Affairs (see below). Mr Abbott was convinced that such a letter could still be obtained.

Arguments for HMRC

21. Mr Bradley indicated that there was no doubt that Dr Saund had made an investment in LCL, and HMRC acknowledged the circumstances current at the time of the board meeting of LCL. However Dr Saund could not simply choose to do what he wanted in order to substantiate his claim. There had been an enquiry, closed in January 2011; the enquiry and closure notice were valid. HMRC raised no objection to the late notification of the appeal to HMC&TS.

22. Mr Bradley referred to the facts of Dr Saund's case. HMRC's first contention was that whilst there may have been an intention on his part to subscribe for shares, this had never happened. Intention on its own was not sufficient for the purposes of s 574 ICTA 1988. At minimum, the details of the shareholding needed to be entered into the company register of LCL. (Mr Bradley referred to the existence of company law penalties for failing to convert shares noted in a company's register to actual shares.)

23. As a result of the decision to liquidate LCL, Wilson Field had been instructed. In the Report of the directors, Dr Saund's investment had throughout been shown as "Directors Loans"; the only shareholding shown was a single share. This showed that the process following the board meeting on 12 January 2007 had not been completed. The Statement of Affairs had been signed by Dr Saund as "a full, true and complete statement as to the affairs of the above named company" as at the date of the resolution for the winding up of LCL.

24. Section 574 ICTA 1988 required that the shares must have been issued. Here neither of the relevant events (subscription and issue) had taken place. Dr Saund's investment had therefore not complied with s 574(3) ICTA 1988. Mr Bradley referred to the Tribunal decision in *John Halnan and Mathew Squire v Revenue and Customs Commissioners* [2011] UKFTT 580 (TC), TC01423, which he described as a similar case to that of Dr Saund. HMRC accepted that Dr Saund had been under pressure at the time of the Statement of Affairs, but there was no evidence that the Statement of Affairs had been queried. It followed from *Halnan and Squire* that the notes of a board meeting did not commit the company to issue shares; if this had been done, the register would have been noted accordingly.

25. HMRC's conclusion on the first contention was that Dr Saund had made a large investment which did not qualify for relief under s 574 ICTA 1988, but that the loss could be carried forward under s 253 of the Taxation of Capital Gains Act 1992 ("TCGA 1992"). The funds had been treated as a loan; whatever the purpose in investing those funds, it had not been specifically to purchase shares at the time when the payments had been made. Mr Bradley submitted that there was no dispute that the shares had not been issued.

26. HMRC's second contention was that, even if the shares could be shown to have been issued, they had been of no value at the time of issue, and therefore no loss could have been incurred. Dr Saund had failed to show that the value of LCL's business had been any greater one week before the date of the liquidation resolution than it was at the time of that resolution.

27. In the light of HMRC's contentions, HMRC asked the Tribunal to dismiss Dr Saund's appeal.

28. In respect of a point made by Mr Abbott in the course of his reply to Mr Bradley's arguments, Mr Abbott had referred to a point on evidence concerning the Statement of Affairs of LCL. Mr Bradley requested that the Tribunal should deal with that point as it saw fit. He also commented that the Companies Act 2006 had not been in force at the time of the Statement of Affairs. He referred to a statement in Halsbury's Laws that allotment was not the same as registration. His comment as to availability of relief under s 253 TCGA 1979 had been intended simply to indicate that there was another option for relief in respect of the investment; no inference was to be drawn from his reference to this possibility.

Discussion and conclusions

29. In the Notice of Appeal, Dr Saund's accountants stated that they had been awaiting Tribunal information from HMRC; in a letter dated 10 February 2011 it had been indicated by HMRC that the matter had been referred for technical advice. The accountants had only been advised recently to take the matter to the Tribunal, by agreement with HMRC dated 2 June 2011.

30. Although we did not find this explanation clear, we were satisfied by Mr Bradley's submissions that HMRC raised no objection to the admission of the late appeal. We therefore considered, in the light of the matters raised by the appeal, that it was in the interests of justice for it to be admitted despite the late notice.

31. In his argument, Mr Abbott referred to Dr Saund's circumstances at the time from the board meeting of LCL to the production of the Statement of Affairs. We need to set out those circumstances. Dr Saund's wife was terminally ill with ovarian cancer. He was continuing with his work in his dental practice, and was also dealing with the problems which had emerged in relation to LCL. We accept that these circumstances, for which we express our great sympathy for him (as did Mr Bradley on behalf of HMRC), prevented him from devoting his full attention to the precise position concerning LCL.

32. The only approach available to us is to examine the position by reference to the requirements of the legislation, and then to consider to what extent the circumstances of Dr Saund and his wife at the relevant time can be taken into account in applying the legislation.

33. Section 574(1) ICTA 1988 contains a series of conditions to be fulfilled in order for the relief to be available. The first is that the individual has subscribed for shares

in a qualifying trading company. There was no suggestion that LCL was not a qualifying trading company; the remaining requirement is that Dr Saund "subscribed" for shares. The remaining principal condition, considered below, is that the individual has incurred an allowable loss on the disposal of the shares.

34. In the particular circumstances, did Dr Saund "subscribe" for shares? Section 574(3)(a) ICTA 1988 provides the definition of "subscribes" for the purposes of s 574; the two conditions are that the shares are "issued" to the individual by the company, and that this must be in consideration of money or money's worth.

35. It is clear from the correspondence and from Dr Saund's evidence that the sums in question were to be applied from his director's loan account with LCL. It is also clear from the minutes of the board meeting on 12 January 2007 that shares were agreed to be allotted and to be issued to Dr Saund. The question arising is whether that agreement was sufficient to meet the requirements of s 574 ICTA 1988.

36. Section 574 contains no definition of the word "issued", nor is any such definition contained in the relevant part of ICTA 1988. Its meaning is therefore to be ascertained by reference to company law. Mr Bradley provided two extracts from Halsbury's Laws of England (Companies), paragraphs 1092 and 1045. We do not find it necessary to set these out in full in this decision; however, the following extract from paragraph 1045 provides assistance:

> "At common law, the term 'issue' in relation to shares means something distinct from allotment and imports that some subsequent act has been done whereby the title of the allottee has been completed. The allotment creates an enforceable contract for the issue of the shares. The shares are issued when an application to the company has been followed by allotment and notification to the purchaser and completed by entry on the register of members."

The authority cited for the propositions in this extract is *National Westminster Bank plc v IRC, Barclays Bank v IRC* [1995] 1 AC 119, 67 TC 1.

37. In the case of LCL, the shares intended to be issued to Dr Saund were allotted in the course of the board meeting, but the Secretary did not take the actions set out in the minutes.

38. We fully understand the difficult circumstances which prevented this from happening. However, we are unable to make a finding inconsistent with the factual position. No entry was made in the register of members of LCL. The consequence of this omission is that the shares cannot be said to have been issued to Dr Saund. We therefore find that the shares were not issued to him.

39. Although the circumstances in his case are different in certain respects from those of the appellants in *Halnan and Squire*, both cases involved the intention to subscribe, but the absence of fulfilment of the necessary formalities required to establish that the shares had been issued. We agree with the conclusions of the Tribunal in *Halnan and Squire*, and with its detailed comments on the applicable principles. Mr Abbott sought to distinguish that case on the basis that one of the three

directors of the relevant company was not present at the board meeting. We do not think that this difference affects the main conclusion in that case, namely that the shares had not been issued as required by s 574 ICTA 1988. Our finding in respect of Dr Saund matches that main conclusion.

40. The Statement of Affairs of LCL showed the issued share capital of LCL as consisting of one share. In the course of correspondence, Dr Saund's accountants stated:

> "On the Report of the Directors, our client advised the liquidators in writing of the correction needed in the report but the liquidators advised that since the overall debt position remained the same, and they were not willing to incur the non-recoverable significant cost of correcting all the documentation and re-issuing it to the many creditors and organisations, they would leave it as such.
>
> Since our client's likelihood of recovering funds remained the same i.e. nil, he did not argue the point and given the rapidly moving events during the early part of 2007 and the stress he was under as a result of the liquidation and family illness, this was not surprising."

41. On the basis of our finding that the shares were not issued to Dr Saund, we do not think that it would have been correct for the Statement of Affairs to be altered as Dr Saund and his advisers contended. The question of additional evidence which might possibly have been sought from the liquidators does not therefore arise. The Statement of Affairs reflected the position of LCL as it was, not as Dr Saund intended it to be; it is unfortunate that the difficult circumstances in which he found himself at the time cannot alter the position.

42. Our conclusion that the shares were not issued to Dr Saund is sufficient to determine the result of his appeal. However, in case for any reason our conclusion is subsequently considered not to be correct, we consider the second matter raised by HMRC, ie whether the shares said to have been issued to Dr Saund gave rise to an allowable loss as required by s 574(1) ICTA 1988. For this purpose, we work on the hypothesis that (despite our contrary finding above) the shares were issued to Dr Saund.

43. For an allowable loss to arise, there must be a disposal. The relevant provisions are s 24(1) and (2) TCGA 1992. The latter requires that the asset in question has become of negligible value. The significant words in the sub-section, in the context of Dr Saund's claim for loss relief under s 574 ICTA 1988, are "has become". The argument for Dr Saund is that at the time of the board meeting, the value of LCL reflected the value of the financial support which he was providing to LCL at the time, and that it was only after he withdrew that support that the value in the shareholding was lost. HMRC's argument was that there could have been no difference between the value of the shareholding in LCL as at 12 January 2007, the date of the board meeting at which the resolution to allot shares was passed, and the date of the resolution to wind up LCL.

44. We are prepared to acknowledge as a general principle that continuing provision of financial support to a company in its "start-up" phase may in certain circumstances justify a valuation higher than would be the case if other valuation principles were applied. However, it is necessary to consider the actual financial situation of the company. It is clear that Dr Saund was already concerned, by the time of the 12 January board meeting, that financial information was not reaching him. We derive the inference that he was anxious as to LCL's financial position. Further, what needs to be considered is the objective value of the shareholding at that date; the state of his subjective knowledge does not assist in arriving at this value. The actual position of LCL appears to have been adverse, leading to the conclusion that removal of Dr Saund from the list of creditors, at least as to the amount covered by the allotment of shares, would assist in improving LCL's financial position.

45. In order to show that the value had been lost, the burden of proof fell on Dr Saund. We do not find Mr Abbott's generalised submissions as to the valuation of start-up companies sufficient to discharge the burden of proving that the value of the allotted shareholding in LCL as at 12 January 2007 was equal to the amount which Dr Saund subscribed from his director's loan account. Further, we are not satisfied that the shares had any value at the time of allotment, given that it became apparent so shortly after the board meeting that there was no value left in LCL.

46. If the shares were of no value at the time of the subscription, they could not "become" of negligible value. It follows that there was no disposal of the shares in 2006-07.

47. Although the point was not raised, it appears to us that there may have been a disposal on 8 August 2009, the date on which LCL was dissolved. This would be on the basis that the extinction of the shareholding fell within s 24(1) TCGA 1992. As this question presupposes that there was an issue of shares, which we have found did not take place, we do not find it necessary to make any further comment on what appears to be an academic point.

48. In the light of our finding that no shares were issued to Dr Saund following the board meeting on 12 January 2007, we find that the amendment made by the closure notice issued by HMRC on 21 January 2011 was correctly and properly made. We therefore dismiss Dr Saund's appeal.

Right to apply for permission to appeal

49. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply, pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, for permission to appeal against it on a point of law to the Upper Tribunal. 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.

JOHN CLARK
TRIBUNAL JUDGE

RELEASE DATE: 3 December 2012