[2018] UKFTT 96 (TC)

TC06354

Appeal number: TC/2017/02515

INCOME TAX – enterprise investment scheme relief – company limited by guarantee – whether controlled by issuing company – whether a subsidiary of issuing company – if so, whether a qualifying subsidiary – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

HUNTERS PROPERTY PLC **Appellant**

- and -

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

TRIBUNAL: JUDGE JONATHAN CANNAN

Sitting in public in Manchester on 6 November 2017

Mr Keith Gordon instructed by Garbutt and Elliot Chartered Accountants for the Appellant

Mr Simon Foxwell of HM Revenue & Customs Solicitor's Office and Legal Services for the Respondents

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DECISION

Background

1. This appeal concerns entitlement to enterprise investment scheme ("EIS") relief in connection with the issue of shares by the appellant. The shares were issued on 2 April 2015 and 6 May 2015. Thereafter the appellant submitted forms EIS1 to the respondents declaring that the shares issued satisfied the requirements for EIS relief contained in Part V Income Tax Act 2007 ("ITA 2007"). The respondents refused to give the appellant authority to issue EIS3 compliance certificates to its shareholders on the basis that certain requirements were not satisfied. In particular, the respondents formed the view that:

(1) the appellant controlled a company which was not a qualifying subsidiary and therefore failed the "control requirement" in section 185(1) ITA 2007, and

(2) the appellant had a subsidiary which was not a qualifying subsidiary and therefore failed the "qualifying subsidiary requirement" in section 187 ITA 2007.

2. The respondents refused authority to issue compliance certificates based on the relationship between the appellant and Greenrose Network Marketing Association Ltd ("Greenrose"), a company limited by guarantee.

3. Section 206 ITA 2007 provides that the refusal of an officer to authorise the issue of a compliance certificate is an appealable decision for the purposes of the Taxes Management Act 1970. The appellant's grounds of appeal may be summarised as follows:

(1) the appellant did not control Greenrose,

(2) Greenrose was not a subsidiary of the appellant, and

(3) if the appellant did control Greenrose and Greenrose was a subsidiary, then Greenrose was a qualifying subsidiary.

4. The statutory framework in which these issues arise may be briefly summarised. All references in this decision are to ITA 2007 save where otherwise stated.

5. In broad terms EIS is designed to attract investment in the share capital of smaller, higher risk companies by giving tax relief to investors. Relief is given in the tax year the investment is made where various conditions are satisfied. If the conditions are not satisfied for a period usually of three years then the relief is withdrawn.

6. Eligibility for EIS relief requires the conditions set out in section 157 to be satisfied. For present purposes I am concerned with section 157(1)(d) which requires the company issuing the shares to be a "qualifying company". A company will be a qualifying company where it satisfies the requirements of section 180. For present purposes I am concerned with the requirement as to "control and independence" in section 185 and the requirement as to "qualifying subsidiaries" in section 187.

7. Section 185 provides as follows:

> " (1) The control element of the requirement is that—
>
> (a) the issuing company must not at any time in period B control (whether on its own or together with any person connected with it) any company which is not a qualifying subsidiary of the issuing company, and
>
> (b) no arrangements must be in existence at any time in that period by virtue of which the issuing company could fail to meet paragraph (a) (whether during that period or otherwise).
>
> (2) The independence element of the requirement is that—
>
> (a) the issuing company must not at any time in period B—
>
> (i) be a 51% subsidiary of another company, or
>
> (ii) be under the control of another company (or of another company and any other person connected with that other company), without being a 51% subsidiary of that other company, and
>
> (b) no arrangements must be in existence at any time in that period by virtue of which the issuing company could fail to meet paragraph (a) (whether during that period or otherwise)."

8. The issue in this appeal concerns the requirement for control, but Mr Gordon for the appellant also referred me to the wording of section 185(2) in relation to independence. In the event he did not place reliance on that sub-section.

9. Section 187 provides as follows:

> " Any subsidiary that the issuing company has at any time in period B must be a qualifying subsidiary of the company."

10. The reference to period B in these requirements refers broadly to a period of 3 years beginning on the date shares in the qualifying company are issued. A breach of the requirements at any time in period B precludes EIS relief from being available. Both parties agree that the issues which arise may conveniently be determined as at 6 May 2015 when the relationship between the appellant and Greenrose was first established. If the requirements were not satisfied at that date then EIS relief is not available.

11. I consider these provisions in detail when setting out reasons for my decision below. There were no issues of fact in the appeal and the parties helpfully provided a short Statement of Agreed Facts.

Findings of Fact

12. The following findings of fact are based on the parties' Agreed Statement of Facts.

13. The Hunters estate agency business was originally established in 1992. By 2015 it had over 150 branches, of which 140 were operated as franchises. The appellant was incorporated on 19 February 2015 as a parent company of the group. It owned 100% of the shares in Hunters Property Group Ltd which in turn owned 100% of the shares in Hunters Franchising Limited ("HFL").

14. On 2 April 2015 the appellant issued shares to investors which it was hoped would qualify for EIS.

15. On 1 May 2015 HFL acquired the entire shareholding of Greenrose Network (Franchise) Ltd. This provided the group with a further 23 branches operated through franchises. At the same time HFL became the sole member of Greenrose, which is a company limited by guarantee. On the same date the existing director of Greenrose retired and was replaced by two new directors, Mrs Glynis Frew and Mr Edward Jones. Mrs Frew and Mr Jones were also directors and shareholders of the appellant, but they did not control the appellant.

16. On 6 May 2015 the appellant issued further shares to investors which again it was hoped would qualify for EIS relief.

17. Whilst this appeal is concerned with the position at 6 May 2016 there were agreed facts covering the subsequent period. In December 2015 HFL ceased to be a member of Greenrose and was replaced by Mr Jones. Since then Mr Jones has been the sole member of Greenrose.

18. It was common ground at the hearing and I find that Greenrose was merely a vehicle for holding client funds and had no intrinsic value of its own. It was also an agreed fact and I find that:

> "… in the exercise of their roles as directors and (in Mr Jones' case) sole membership of Greenrose Marketing, they act in their own personal capacities."

19. Further, when the appellant became the new holding company in 2015 it replaced Hunters Property Group Limited which had been prospectively approved for EIS relief in 2014.

20. During the course of the hearing I was also referred to some further documents which the parties were content should be admitted in evidence. Firstly, the articles of association of Greenrose and secondly the annual accounts of the appellant, HFL and Greenrose for the period ending 31 December 2015. Based on this documentation I find the following facts.

21. The articles of association of Greenrose provide that the Table A articles shall apply to the company unless excluded or varied. Apart from subscribers, no person shall be admitted as a member of the company unless approved by the directors. The directors are appointed by the member(s).

22. The accounts of Greenrose for the period ending 31 December 2015 show net assets of nil and it is described as a "not-for-profit organisation". There were wages to

directors of £2,573 but it is stated that the directors are not remunerated through Greenrose and that wages costs represent recharges from a member company. It is not evident whether those wages were paid before or after 1 May 2015.

23. The appellant's accounts for the period ending 31 December 2015 show at Note 34 a list of subsidiaries at that date which does not include Greenrose. The accounts of HFL for the period ending 31 December 2015 include at Note 21 in relation to subsidiaries a reference to Greenrose. It is said that HFL acquired and disposed of an interest in Greenrose during the period.

Reasons

24. The issues in this case arise from the fact that Greenrose is a company limited by guarantee and that from 1 May 2015 until December 2015 the appellant's indirect subsidiary HFL was the sole member of Greenrose.

25. Both parties made their submissions on the basis that the provisions for EIS relief in Part V ITA 2007 are a highly prescriptive code. They did not seek to go beyond the ordinary meaning of the statutory words. Mr Gordon accepted that the provisions were to be applied strictly. If the provisions contain any gap then it is not open to a tribunal to fill the gap. Mr Gordon's submission was that Parliament had chosen to provide that control of companies limited by guarantee would not amount to non-compliance with the requirements for EIS relief.

26. In making submissions on that basis I infer that the parties were acknowledging what was said in relation to EIS relief by the Upper Tribunal in *Flix Innovations Ltd v Commissioners for HM Revenue & Customs [2016] UKUT 0301 (TCC)* at [43]:

> " 43. We also accept that Part 5 ITA 2007 is, as the FTT found, "closely articulated" legislation. Again, as this Tribunal said in *Trigg* at [33], the fact that the relevant legislation is highly detailed, prescriptive or "closely articulated" does not exclude the general principle that the statutory words must receive a purposive construction. Nonetheless, it is true, as Lewison J indicated in *Berry*, that highly prescriptive or formulaic legislation will often give less scope for a purposive interpretation resulting in a meaning which is different from the literal meaning."

27. I turn now to consider the three issues arising on the appeal.

(1) Control of Greenrose

28. The first issue is whether the appellant controlled Greenrose with effect from 6 May 2015 for the purposes of section 185(1)(a).

29. The ordinary meaning of control for the purposes of ITA 2007 is contained in section 995 which provides as follows:

> " (1) This section has effect for the purposes of the provisions of the Income Tax Acts which apply this section.

(2) In relation to a body corporate ("company A"), "control" means the power of a person ("P") to secure—

(a) by means of the holding of shares or the possession of voting power in relation to that or any other body corporate, or

5 (b) as a result of any powers conferred by the articles of association or other document regulating that or any other body corporate,

that the affairs of company A are conducted in accordance with P's wishes."

30. However, this ordinary meaning of control is disapplied by section 257(3) for the purposes of section 185(1)(a). For the purposes of section 185(1)(a) control is
10 defined in accordance with sections 450 and 451 Corporation Tax Act 2010 ("CTA 2010"). Section 450 CTA 2010 provides as follows:

" (2) A person ("P") is treated as having control of a company ("C") if P—

(a) exercises,

(b) is able to exercise, or

15 (c) is entitled to acquire,

direct or indirect control over C's affairs.

(3) In particular, P is treated as having control of C if P possesses or is entitled to acquire—

(a) the greater part of the share capital or issued share capital of C,

20 (b) the greater part of the voting power in C,

(c) so much of the issued share capital of C as would, on the assumption that the whole of the income of C were distributed among the participators, entitle P to receive the greater part of the amount so distributed, or

(d) such rights as would entitle P, in the event of the winding up of C or in any
25 other circumstances, to receive the greater part of the assets of C which would then be available for distribution among the participators."

31. The appellant argues that it does not satisfy this definition of control because the persons in control of Greenrose were Mrs Frew and Mr Jones. Mr Gordon relied on the agreed fact that those individuals act "in their own personal capacities". The
30 appellant was never a member of Greenrose and was never a director of Greenrose. Therefore, the appellant had no control over Greenrose.

32. Mr Foxwell submitted that as at 6 May 2015 the appellant, through its indirect controlling interest in HFL, was able to control Greenrose. HFL was the sole member of Greenrose and control of Greenrose lay with its members. HFL had the power to
35 appoint and remove directors.

33. I accept Mr Foxwell's submission. Regulation 5 of Greenrose's articles of association provide that the members, namely HFL, could appoint any person to be an additional director. Hence HFL could appoint a majority of new directors if it was so minded. There is also power in section 168 Companies Act 2006 whereby HFL could remove Mrs Frew and Mr Jones as directors. As such, in my view it is clear that the appellant was able to exercise indirect control over the affairs of Greenrose within section 450(2) CTA 2010.

34. Mr Gordon submitted that in the light of the agreed fact that Mrs Frew and Mr Jones acted as directors of Greenrose in their own personal capacities the respondents had failed overcome the evidential burden of establishing that the appellant had control over Greenrose. I do not accept that submission. It is clear from the articles of association which were in evidence and the agreed fact that HFL was the sole member of Greenrose and an indirect subsidiary of the appellant that the appellant could thereby control Greenrose as at 6 May 2015.

35. I note that section 451(3) CTA 2010 provides that if a person possess any rights or powers on behalf of another person (A), then those rights or powers are to be attributed to A for the purposes of section 450. The respondents did not rely on this provision, presumably because it was an agreed fact that Mrs Frew and Mr Jones acted as directors of Greenrose in their own personal capacities. As such, section 451(3) could not operate on the facts of this case. However, for the reasons in the preceding paragraphs it is not necessary for the respondents to rely on section 451(3).

(2) Was Greenrose a Subsidiary of the Appellant?

36. The appellant argues that Greenrose was not a subsidiary of the appellant. There is some overlap between the appellant's submissions on this issue and on the third issue, namely if Greenrose was a subsidiary of the appellant then was it a qualifying subsidiary.

37. The term "qualifying subsidiary" is defined in section 191 which provides as follows:

> " (1) For the purposes of this Part, a company ("the subsidiary") is a qualifying subsidiary of another company ("the relevant company") if the following conditions are met.
>
> (2) The conditions are that—
>
> > (a) the subsidiary is a 51% subsidiary of the relevant company,
> >
> > (b) no person other than the relevant company, or another of **its subsidiaries**, has control of the subsidiary, and
> >
> > (c) no arrangements are in existence by virtue of which either of the conditions in paragraphs (a) and (b) would cease to be met."

Emphasis added

38. The term "51% Subsidiary" is defined in section 989 by reference to CTA 2010, where section 1154(2) CTA 2010 provides that B is a 51% Subsidiary of A "if more than 50% of B's ordinary share capital is owned directly or indirectly by A".

39. Mr Foxwell for HMRC submitted that Greenrose was a subsidiary of the appellant by virtue of the fact that the appellant had control of Greenrose. However, he submitted that it was not a 51% subsidiary. It did not have a share capital and indeed since 1980 no company limited by guarantee can have a share capital (see section 5 Companies Act 2006). As such it could not be a 51% subsidiary.

40. Mr Gordon's primary case on behalf of the appellant is that the requirements of sections 185 and 187 do not apply in relation to a company limited by guarantee. He submitted that use of the term "subsidiary" in sections 187, 191 and thereby section 185 was referring to a company that would be regarded as a subsidiary by virtue of share ownership. In other words a company where more than 50% of its share capital is owned by another company. He described these as "actual subsidiaries". A company limited by guarantee which does not have a share capital is not treated as a subsidiary.

41. In making that submission Mr Gordon relied in particular on the reference to "any subsidiary" in section 187 and "its subsidiaries" in section 191(2)(b). He submitted that those terms were not defined as such by the provisions. Further, he submitted that the reference to "the subsidiary" and the definition of "qualifying subsidiary" in section 191(1) was not simply a label chosen by Parliament, but gave a clue to the fact that the requirements in section 185 and 187 only applied to what would "traditionally be considered to be a subsidiary".

42. Mr Gordon submitted that the natural starting point for the meaning of subsidiary is section 1162 Companies Act 2006, originally introduced by the Companies Act 1989.

43. In *South Shore Mutual Insurance Co Ltd v Blair [1999] STC (SCD) 296* the Special Commissioner (Dr Brice) was concerned with a company limited by guarantee which claimed entitlement to group relief in respect of losses incurred by members. The Revenue refused relief on the ground that it did not have any ordinary share capital and was not therefore a 75% subsidiary. The taxpayer's appeal was dismissed on the basis that the company did not have an issued share capital. The parties did not rely on that finding as such, but on the approach to construction and in particular at [51] where Dr Brice stated:

> " 51. It seems, therefore, that Canada Safeway is authority for the view that the phrase 'issued share capital' has to be construed by reference to its meaning in the Companies Acts."

44. Mr Gordon submitted that in the absence of a definition in tax legislation a company law term would normally take its meaning from company law. In fact, section 1162 Companies Act 2006 refers to subsidiary undertakings and section 1159

seems more apposite, although for present purposes the sections may be considered to have the same effect. Section 1159 provides:

> " (1) A company is a "subsidiary" of another company, its "holding company", if that other company—
>
> 5 (a) holds a majority of the voting rights in it, or
>
> (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
>
> (c) is a member of it and controls alone, pursuant to an agreement with other members, a majority of the voting rights in it,
>
> 10 or if it is a subsidiary of a company that is itself a subsidiary of that other company."

45. It was common ground that the reference to Greenrose in Note 21 to HFL's accounts reflected this definition.

46. On the face of it, the definition of a subsidiary for company law purposes does not support Mr Gordon's argument. Greenrose would appear on this definition to be a 15 subsidiary of HFL as at 6 May 2015 and therefore a subsidiary of the appellant. However, Mr Gordon noted that this meaning was introduced in 1989 and that the previous definition had been narrower. I was not taken to the previous definition, but Mr Gordon submitted that the term 'subsidiary' "ought to be construed more narrowly, in accordance with the more natural meaning of the word, and not in 20 accordance with any extended meaning as conferred (from time to time) by statute under company law".

47. I do not consider on the material before me that Mr Gordon's argument for a narrower definition of the term "subsidiary" in Part V ITA 2007 can be sustained. There is no basis on the material to which I have been referred to exclude companies 25 limited by guarantee from the references to subsidiaries in Part V.

48. Mr Gordon went on to submit that in cases of ambiguity it is permissible to look at the predecessor to ITA 2007 in relation to EIS relief. Relief was available for standalone companies and "parent companies of trading groups". Section 293(3A) Income and Corporation Taxes Act 1988, introduced by the Finance Act 1997 defined 30 the latter companies so as to permit companies with subsidiaries to qualify for relief if, inter alia, each subsidiary was a qualifying subsidiary. He submitted that there was a "clear implication" in that provision that a subsidiary must have issued share capital.

49. Even if there were any ambiguity, which I do not consider there is, I do not accept that the previous legislation takes Mr Gordon's arguments any further. Indeed, 35 use of the word subsidiary in section 293(3A) postdates the Companies Act 1989 and I see no reason why Parliament should not have been referring to the meaning of subsidiary in that Act.

50. Mr Gordon also submitted that the tax regime as a whole uses the word "subsidiary" to refer to a company which has share capital. He referred to a number of tax statutes where express provision is made for companies not having a share capital, two of which are in the context of defining group structures – section 345(9) Taxation (International and Other Provisions) Act 2010 and Reg 2(2) Scientific Research Organisations Regulations 2007. The latter regulation for example defines a 100% subsidiary and expressly includes a company limited by guarantee having only one member. Mr Gordon submitted that in the absence of any reference to a company limited by guarantee, a subsidiary must have issued share capital.

51. I do not accept that submission. The way in which Parliament has treated companies limited by guarantee in other contexts does not in my view assist in the present context.

52. In support of the appellant's argument, Mr Gordon submitted that the purpose of section 185 in relation to control and independence was to ensure that EIS relief is not given in relation to investors in an issuing company where value can "leak" through a different company. This, he said is not something that ought to arise with a company limited by guarantee. I was not taken to the power of Greenrose to make distributions to members but I note that the Table A provisions in relation to payment of dividends were excluded in its articles of association.

53. It seems to me that Mr Gordon's submission in this regard involves a purposive construction of Part V ITA 2007 going beyond the ordinary meaning of the statutory words. I do not consider that such an approach is permissible, and indeed Mr Gordon acknowledged as much at the outset of his submissions.

54. By way of submissions in reply, Mr Gordon submitted that if Mr Foxwell was right that a company limited by guarantee could be a subsidiary caught by section 185 and 187, then section 187 would be redundant. In other words, if Greenrose was a subsidiary simply because it was under the control of the appellant, then requiring a subsidiary to be a qualifying subsidiary also by reference to control would be an unnecessary additional requirement. Control was already a requirement of section 185(1)(a).

55. I do not accept Mr Gordon's submission. In my view section 187 is an additional requirement over and above section 185(1)(a) and would not be redundant. The definition of a qualifying subsidiary is by reference to the three conditions in section 191(2) including reference to control. Control for the purpose of identifying a subsidiary is found in section 1159 Companies Act 2006, control for the purpose of section 185(1)(a) is in section 450 CTA 2010 and control for the purpose of section 191(2) is in section 995.

56. Section 995 defines control by reference to a holding of shares, the possession of voting power or powers in the articles of association or other document whereby the affairs of company A are conducted in accordance with P's wishes. In contrast, section 450 is broader and simply looks at whether P is able to exercise control over

company C's affairs and goes on to give circumstances where that test will be treated as being satisfied.

57. The test for control in section 185(1)(a) is therefore different to the test for identifying a qualifying subsidiary in section 187, including the company law test for 5 for identifying a subsidiary, albeit all three tests involve and use the word "control". There may be an overlap but the tests are not identical.

58. I am not satisfied therefore that section 187 is redundant if the requirements apply to companies limited by guarantee. In any event, arguments from redundancy do not generally carry much weight – see for example *DMWSHNZ Ltd v* 10 *Commissioners for HM Revenue & Customs [2015] EWCA Civ 1036* at [38].

59. In the circumstances I am satisfied that Greenrose was a subsidiary of the appellant as at 6 May 2015.

(3) Qualifying Subsidiary

60. Finally, and in the alternative, Mr Gordon argued that the conditions in section 15 191(2) were satisfied. He submitted that "[Greenrose] has no ordinary share capital and, therefore ***all*** of its (non existent) share capital is owned by the appellant". I accept Mr Foxwell's reply to that submission. It is not possible to own at least 51% of something that does not exist. In my view Mr Gordon's construction does unnecessary violence to the plain statutory language.

20 61. Mr Gordon submitted that there was no policy objection to a company limited by guarantee such as Greenrose being in a group where the parent qualifies for EIS relief. There was no way in which Greenrose would enable value to be leaked out of the group. For the reasons given above I reject that submission.

62. In the circumstances I am satisfied that Greenrose was not a qualifying 25 subsidiary of the appellant as at 6 May 2015.

(3) Generally

63. In the final analysis I consider that the issues can be straightforwardly resolved. The appellant clearly controlled Greenrose whilst HFL was a member of Greenrose by reference to the definition of control in section 450(2) CTA 2010. Greenrose was a 30 subsidiary of the appellant applying the definition in the Companies Act 2006. Where a company has no share capital it cannot be a qualifying subsidiary because it cannot be a 51% Subsidiary.

64. Finally, and for the sake of completeness, Mr Foxwell submitted that it was HMRC's long held view that a company limited by guarantee "breaks a group". In 35 his skeleton he had also submitted that a company "must have issued share capital to be a subsidiary". The first submission is not relevant for present purposes because we are not immediately concerned with whether there is a group structure. It is necessary to focus simply on the provisions of ITA 2007. The second submission appears to

inadvertently omit the word "qualifying" before subsidiary. Otherwise, I have rejected the submission for the reasons given above.

Conclusion

65. In all the circumstances and for the reasons given I dismiss the appeal.

5 66. 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
10 "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

15 **JONATHAN CANNAN**
TRIBUNAL JUDGE

RELEASE DATE: 23 FEBRUARY 2018