



Appeal number: UT/2020/0016 (V)

INCOME TAX – enterprise investment scheme – whether shares carry preferential rights falling within s173(2A) of ITA 2007 – yes – appeal dismissed

**UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)**

FOOJIT LIMITED

Appellant

-and-

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

Respondents

**TRIBUNAL: MR JUSTICE MANN
JUDGE JONATHAN RICHARDS**

Sitting in public by way of remote video hearing treated as taking place at The Royal Courts of Justice, Rolls Building, London on 18 January 2021

Richard Chapman QC instructed by Grant Thornton UK LLP for the Appellant

Charles Bradley, instructed by the General Counsel and Solicitor for Her Majesty's Revenue and Customs for the Respondents

DECISION

1. The appellant company (the “Company”) appeals against a decision (the “Decision”) of the First-tier Tribunal (the “FTT”) released on 13 November 2019 in which the FTT dismissed the Company’s appeal against HMRC’s refusal to issue compliance certificates for the purposes of the enterprise investment scheme (the “EIS”) set out in Part 5 of the Income Tax Act 2007 (“ITA 2007”) in respect of shares (“B Shares”) that the Company issued in 2014. The hearing before us took the form of a fully remote video hearing and neither party suggested that it should take any different form.

Statutory provisions

2. Section 157 of ITA 2007 provides for an individual to be entitled to a tax relief (described in the legislation as “EIS relief”) on the subscription for “relevant shares” in a company provided a number of conditions are satisfied. In particular, the relevant shares must satisfy the requirements of s173 of ITA 2007 which, so far as material, provides as follows:

173 The shares requirement

(1) The relevant shares must meet—

(a) 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—

(a) any present or future preferential right to dividends that is within subsection (2A),

(aa) any present or future preferential right to a company's assets on its winding up, or

(b) any present or future right to be redeemed.

(2A) A preferential right to dividends carried by a share in a company is within this subsection if—

(a) the amount of any dividends payable pursuant to the right, or the date or dates on which they are payable, depend to any extent on a decision of the company, the holder of the share or any other person, or

(b) the amount of any dividends that become payable at any time pursuant to the right includes any amount that became payable at any earlier time pursuant to the right, but has not been paid.

3. It was common ground that the B Shares carried no preferential right to the Company’s assets on a winding up falling within s173(2)(aa) and no right to be redeemed falling within s173(2)(b). These proceedings, therefore, concern the effect of the prohibition set out in s173(2)(a). It was common ground that this prohibition did not prevent shares from carrying any present or future preferential rights, but only a restriction on shares carrying preferential rights which fall within s173(2A).

Factual background

4. The factual background was not in dispute and is set out in paragraphs [5] to [12] below with references to numbers in square brackets being to paragraphs of the Decision.

5. The Company was incorporated in England & Wales on 22 January 2014. On incorporation, its Articles of Association were the model articles of association set out in the Companies (Model Articles) Regulations 2008 (the “Model Articles”).

6. In 2014, the Company issued shares to investors that it wished to qualify for EIS relief. To that end, on 18 November 2014, it adopted new articles of association (the “Articles”) that set out, among other matters, the terms of A Shares and B Shares to be issued. The Articles, however, continued to incorporate aspects of the Model Articles with Article 1.2 providing as follows:

1.2 These Articles and the provisions of the Model Articles (subject to any modifications set out in these Articles) shall constitute all the articles of association of the Company.

7. Article 2 set out the dividend rights associated with the B Shares as follows:

2. DIVIDENDS

2.1. The Company shall, in priority to the payment of any dividend to all other Members, pay the holders of the B Ordinary Shares a prior dividend equivalent to 44 per cent of the Profits available for distribution.

2.2. The Prior Dividend:

2.2.1. will be paid in cash;

2.2.2. is a fixed percentage which may not be altered by resolution of the board of directors or the members;

2.2.3. shall be distributed amongst the holders of the B Ordinary Shares pro rata according to the number of B Ordinary Shares held by each of them respectively;

2.2.4. is not cumulative; and

2.2.5. will cease to be paid or payable once each B Ordinary Shareholder has received an aggregate of £120,000 in Prior Dividends.

2.3. Subject to Prior Dividend having been paid the balance of any Profits which the Company, on the recommendation of the Directors, determines to distribute in respect of any Accounting Period will be applied, on a pro-rata basis, between the Shares.

8. Article 1 defined various terms as follows:

In these Articles the following words and expressions have the following meanings unless the context otherwise requires:

...

Accounting Period means an accounting period in respect of which the Company prepares its accounts in accordance with the relevant provisions of the Act...

Group means the Company and its subsidiaries from time to time...

Ordinary Share means an A Ordinary Share or a B Ordinary Share of £1 in the capital of the Company having the rights and being subject to the restrictions set out in these Articles,

Prior Dividend means the prior dividend payable on the B Ordinary Shares in accordance with article 2.1,

Profits means the consolidated net profit (if any) of the Company for each Accounting Period as shown in the audited consolidated profit and loss account of the Company in respect of that Accounting Period and adjusted (to the extent not already provided for) as follows:

- (a) after adding back (to the extent to which the same have been charged to profit and loss in the relevant Accounting Period) all the costs borne by the Company during the relevant Accounting Period in connection with the investment provided for in the Investment Agreement and all costs incurred in raising finance at any time;
- (b) after making any provision or reserve for or in respect of any taxation levied upon or assessed by reference to profits earned or gains realised during that Accounting Period;
- (c) after deducting the amount of all interest payments charged on or payable by the Group in respect of that Accounting Period (but excluding any late payment interest due or accrued interest on any such payments);
- (d) before making any provision for the payment of any dividend or other distribution declared or paid by the Group;
- (e) before any provision for the transfer of any sum to reserve or writing off goodwill or any intangible item;
- (f) before deducting profits or losses on the revaluation of any of the assets of the Group;
- (g) before deducting any extraordinary or exceptional items;
- (h) before any amortisation of goodwill arising on the acquisition of any company or business;
- (i) before depreciation of fixed assets;

and any dispute as to the amount of the Profits in respect of any Accounting Period which has not been resolved within 10 Business Days of either the date on which the final audited accounts of the Company (signed by the Auditors) for the relevant Accounting Period are received by the Company or, if earlier, the date which is 4 months after the end of the relevant Accounting Period shall be referred to the Auditors for determination in accordance with article 23;

...

Shares means any shares of any class in the capital of the Company.

...

9. Given the provisions of Article 1.2, which we have quoted at [6] above, the provisions of the Model Articles are also relevant. Later in this decision, we will consider how Article 30 of the Model Articles affects the issues arising in this appeal. For the time being, we simply note that Article 30 of the Model Articles provides as follows:

30 Procedure for declaring dividends

(1) The company may by ordinary resolution declare dividends, and the directors may decide to pay interim dividends.

(2) A dividend must not be declared unless the directors have made a recommendation as to its amount. Such a dividend must not exceed the amount recommended by the directors.

(3) No dividend may be declared or paid unless it is in accordance with the shareholders' respective rights.

(4) Unless the shareholders' resolution to declare or directors' decision to pay a dividend, or the terms on which shares are issued, specify otherwise, it must be paid by reference to each shareholder's holding of shares on the date of the resolution or decision to declare or pay it.

...

10. On 18 November 2014, the Company issued 910 B Shares to investors for an aggregate subscription price of £400,000.

11. On 16 January 2015, the Company submitted a Form EIS 1. In that form, the Company made a "compliance statement" for the purposes of s205 of ITA 2007 confirming the satisfaction of various conditions necessary for investors' subscription for the B Shares to attract EIS relief. The Company also requested HMRC to issue a "compliance certificate" under s204 of ITA 2007 which was necessary to enable investors to claim EIS relief on their subscription for B Shares.

12. On 30 January 2015, HMRC refused to issue the compliance certificate on the ground that the B Shares contained a present or future preferential right to dividends that fell within s173(2A). The Company exercised its right of appeal set out in s206 of ITA 2007 and, following an HMRC review of their decision, which left that decision unaltered, the Company notified that appeal to the FTT on 16 December 2016.

The Decision and the grounds of appeal against it

13. Before the FTT it was common ground, as it was before us, that the B Shares carried a present or future preferential right to dividends as they entitled the holders of those shares to receive dividends in priority to holders of the A Shares. Therefore, the only live question before the FTT, as before us, was whether that preferential right fell within s173(2A) which in turn required an examination of whether either (i) the amount of

dividends payable or (ii) the date or dates on which they are payable depend to any extent on a decision of the Company, the holder of the B Shares or any other person.

14. At [48], the FTT concluded that there was no problem with the first limb of the test as the amount of dividends payable on the B Shares was fixed and did not depend on any decision of the Company or any other person. Neither party challenges that conclusion.

15. The FTT then turned its attention to the date or dates on which dividends on the B Shares became payable. At [52] to [54], the FTT noted that s173(2A) focuses on the date or dates on which dividends are “payable”, not the date or dates on which they are “paid”. Accordingly, the FTT concluded that there would be no contravention of s173(2A) if the Articles provided for dividends on the B Shares to crystallise as a debt on a specific date (that did not depend on the decision of the Company, a shareholder or any person), even if the date on which the dividend was actually paid did depend on such a decision.

16. However, at [55] to [63], the FTT decided that the Articles did not fix any date, prior to the date on which they were paid, on which dividends on the B Shares were payable.

17. The FTT’s first reason, set out at [56], was that Article 2 did not confer on B Shareholders any “right” to a dividend even if there were sufficient Profits available for the purpose. Rather, Article 2 provided that, if the Company paid a dividend to shareholders generally, it could not do so without first paying the Prior Dividend to holders of the B Shares. Therefore, B Shareholders obtained a right to a dividend only once the Company or its directors had first decided to declare a dividend to its shareholders generally. Dividends on the B Shares did not become “payable” until that decision had been made and accordingly s173(2A) was engaged.

18. At [57] to [61], the FTT considered and rejected the Company’s argument that dividends on the B Shares became “payable” as soon audited accounts were prepared which demonstrated that there were sufficient Profits out of which to pay the dividend. It considered at [58] that such an interpretation would be “contrary to business common sense” as it might mean that holders of B Shares would have an entitlement to dividends, even if the Company had insufficient cash with which to pay those dividends.

19. In any event, at [60], it concluded that on this argument the dividends could not become payable until Profits had been ascertained by an individual acting on the Company’s behalf. Bearing in mind the width of s173(2A), this still made the date on which dividends were payable dependent to at least some extent on the acts of the Company, or individuals acting on its behalf.

20. In addition, at [61], the FTT noted that the Articles provided for Profits to be determined before “making any provision for the payment of any dividend or other distribution declared or paid by the Group” (our emphasis). This, the FTT considered, suggested that the Articles required any dividend to be “declared” by the Company, so

pointing against a construction of the Articles under which entitlement to dividends arose independent of an act of the Company, or any other person.

21. For all those reasons, the FTT concluded that the Company's appeal should be dismissed.

The Grounds of Appeal

22. The issues between the parties have narrowed somewhat since the Decision and the following propositions are now common ground:

(1) Section 173(2A) is concerned only with when dividends become "payable", not with when they are actually paid.

(2) The issue is one of construction of the Company's articles of association. If those articles set out a mechanism for establishing a "trigger" on which dividends on the B Shares are payable that does not depend on the decision of any person, then the B Shares do not carry a preferential right falling within s173(2A).

(3) Such a trigger need not involve the specification of a calendar date; an "event trigger" under which dividends are payable on the occurrence of a specific event would be sufficient provided that the event in question does not itself depend on a decision of the Company or any other person.

23. With that ground being common between the parties, the essence of the Company's argument before us was that the Articles provide for dividends on the B Shares to be mandatorily "payable" without the need for any declaration by directors or by the Company in general meeting, as soon as audited accounts are signed off that show Profits sufficient for dividends to be paid, or perhaps as soon as any dispute as to the amount of Profits is determined. That, the Company argues, is an "event trigger" that is not dependent on any decision taken by the Company or any person and is sufficient to take the preferential right on the B Shares outside the scope of s173(2A).

24. HMRC disagree with the Company's premise. In their submission, properly construed, the Articles simply provide for the B Shares to have a priority entitlement to dividends if declared so that, if the Company resolves to pay a dividend, the first 44% of Profits must be paid by way of dividend on the B Shares subject to the overall cap in Article 2.2.5. On that analysis, the preparation of audited accounts, or the resolution of any dispute as to the extent of Profits, is not an "event trigger" of the kind for which the Company argues. Rather, in HMRC's submission, the true trigger for any dividends on the B Shares to become payable is a prior decision, whether by the Company's directors, or its shareholders, that a dividend should be paid.

25. In the alternative, HMRC submitted that, even if the preparation of audited accounts, or the resolution of any disputes as to the amount of Profits were, contrary to their submissions referred to in paragraph 24 above, triggers for dividends on the B Shares to become payable, those triggers still themselves depended on the decisions of the Company and/or other persons. HMRC note, for example, that the Company's directors might choose to adopt a different accounting period which would have an

effect on the date on which audited accounts could be prepared and so a corresponding effect, even on the Company's case, on the date on which dividends on the B Shares become payable. Less dramatically, the directors of the Company could decide to submit the accounts to an auditor for approval on a later or earlier date. Emphasising the width of s173(2A), which is engaged if the dates on which dividends are payable depend "to any extent" on decisions of the Company or any other person, and reasoning by analogy to the Upper Tribunal's decision in *Flix Innovations v HMRC* [2018] UKUT 301 (TCC) HMRC argue that, even on the Company's case, the preferential right on the B Shares falls within s173(2A).

Discussion

26. For reasons that follow, we are unable to accept the premise underpinning the Company's argument set out at paragraph 23 above.

27. In his oral submissions, Mr Chapman QC approached the search for a "trigger" for dividends on the B Shares by starting with Article 2.1, suggesting that it would be necessary to look at the Model Articles only if Article 2.1 failed to disclose a clear trigger.

28. We accept, of course, that the proper construction of Article 2.1 is of critical importance and we will address its construction in more detail below. However, as a preliminary matter, we consider that the Company's approach, as articulated by Mr Chapman, accords insufficient weight to the Model Articles. Article 1.2 of the Articles provides that both the Model Articles and the Articles are to constitute "all the articles of association of the Company" subject to any "modifications" to the Model Articles set out in the Articles. Therefore, in our judgment, it is appropriate to start by having regard to the provisions of both Article 2.1 and Article 30 of the Model Articles which between them set out all operative provisions dealing with the question of when dividends on the B Shares become payable. It is then appropriate to consider the extent to which Article 30 of the Model Articles is "modified" by the specific provisions of the Articles.

29. Approached in that way, it can be seen that Article 30 of the Model Articles contains quite detailed provisions relating to the declaration and payment of dividends. Article 30(1) provides two possible routes: the Company can by ordinary resolution "declare" dividends and, only insofar as interim dividends are concerned, the directors may decide to "pay" such dividends. In his oral submissions, Mr Chapman emphasised that Article 30 provides that the Company and its directors "may" declare, or decide to pay, dividends. However, in our judgment this wording is used simply because Article 30 does not oblige dividends to be declared or paid. We do not, therefore, read Article 30(1) as saying that there are other (unspecified) routes to the payment or declaration of dividends other than (i) the passing of a shareholders' resolution or (ii) (in the case of interim dividends only) a directors' resolution.

30. Therefore, on its face, Article 30(1) provides two routes by which dividends can become payable, both depending on the actions of either the Company in general meeting, or of its directors. Article 30(2) introduces a restriction on the exercise of the

first of these routes: the Company cannot in general meeting declare a dividend at all unless the directors have made a recommendation as to its amount and the Company cannot decide to declare a dividend in excess of the directors' recommended amount.

31. Mr Chapman referred us to Articles 30(3) and 30(4) of the Model Articles, but we do not consider that they contain additional triggers for dividends to become payable by reference to the rights of any particular class of share. Article 30(3) simply states the obvious proposition that any dividends declared or paid must be in accordance with the shareholders' respective rights. Article 30(4) establishes a "record date" for each dividend (namely the date of declaration or payment) but provides power for that record date to be altered in particular cases.

32. Article 2.1 of the Articles contains no express terms at all dealing with the date or dates on which dividends on the B Shares are to become payable. Nowhere in the Company's articles of association is there any statement to the effect that Article 30 of the Model Articles is not to apply to dividends payable on the B Shares. That in itself is significant. As we have noted Article 1.2 of the Articles provides that provisions of the Model Articles are just as much part of the Company's articles of association as the Articles themselves except to the extent of any "modifications" to the Model Articles. Therefore, the absence of any express provision of the Articles to the effect that Article 30 of the Model Articles is "modified" suggests that Article 30 is applicable to all dividends, including those payable in respect of the B Shares, though it is not conclusive because we accept that a modification which is necessitated by the text of the Articles should be given effect to even if there is no express reference to its being a modification.

33. The Company argues that Article 2.1 should be read as containing a modification to Article 30 of the Model Articles so that neither of the routes set out in Article 30 needs to be followed in order to make dividends on the B Shares payable. Its first argument is that Article 2.1 provides that the Company:

shall, in priority to the payment of any dividend to all other Members, pay to the holders of the B Ordinary Shares a prior dividend equivalent to 44 per cent of the Profits available for distribution

[emphasis added]

The use of the word "shall", the Company argues, leaves no room for the kind of discretion envisaged in Article 30 of the Model Articles. In particular, the directors of the Company could not be intended to have the power to deprive the B Shareholders of their dividend by devices such as not recommending a dividend, recommending a lower amount than 44% of Profits or not proposing a Company resolution to declare a dividend at all. Since dividends on the B Shares are, by Article 2.2.4, not cumulative the effect of such devices would be to deprive holders of B Shares of their dividends for ever, a further reason, the Company argues, why the Articles should not be read as permitting them.

34. The difficulty with that argument is that it assumes that the word "shall" is intended to make the dividend mandatory (subject only to the availability of profits available for distribution). However, it is equally possible to read the word "shall" as referring to the priority of the dividend on the B Shares and making it mandatory for the dividend on

those shares to be paid in priority to dividends to all other shareholders. In other words, it qualifies the priority, and does not introduce an obligation to make a distribution. In choosing between those constructions one has to bear in mind the presence of Article 30 of the Model Articles, and reading the two together, and bearing in mind the absence of any express cross-reference to Article 30 which “switches off” the normal routes to the declaration and payment of dividends, we regard it as more natural to read “shall” as referring to the priority of the B Share dividend.

35. Against that, the Company notes that Article 2.3 refers to directors’ recommendations and Company resolutions, when providing that:

the balance of any Profits which the Company, on the recommendation of the Directors, determines to distribute in respect of any Accounting Period will be applied, on a pro-rata basis, between the Shares

That, the Company argues, suggests that the Articles envisage that the ordinary routes to dividends becoming payable, set out in Article 30 of the Model Articles, are to apply only to the “balance” thus supporting an argument that the prior dividend on the B Shares is to be payable automatically without the need for any resolution of the Company or any recommendation by the directors.

36. If the words “which the Company, on the recommendation of the Directors, determines to distribute” are referring to the “balance” only, there may be an inference of the kind to which the Company refers. However, if those words are referring to the “Profits”, no such inference arises. Indeed, in that case, Article 2.3 would raise an inference supportive of HMRC’s case, namely that any distribution of Profits, including the prior dividend on the B Shares, would require a resolution of the Company following a recommendation by the directors. For our part we consider that, in the context of Article 30, the latter construction is more to be favoured.

37. The Company argues that, since it wished to secure EIS relief for investors in the B Shares, where the correct interpretation of the Articles is debatable, we should adopt an interpretation that secures that EIS relief. However, we agree with HMRC that the Company’s private intentions, even if proved by evidence, are not an aid to the construction of its articles of association which are required to be registered at Companies House so that they can be read and understood by the world at large (see paragraph 36 of the judgment of the Privy Council in *A-G of Belize v Belize Telecom Ltd* [2009] 1 WLR 1998).

38. Mr Chapman submitted that, on HMRC’s interpretation of the Company’s articles of association, the directors of the Company could employ devices to frustrate the preferential entitlement of holders of B Shares. However, we do not consider that this submission sheds much light on the meaning or effect of the Articles or Model Articles. Holders of B Shares enjoy a preferential right to dividends up to 44% of Profits available for distribution subject to an overall cap. Therefore, any devices employed to frustrate the preferential rights on the B Shares, such as directors making no recommendation as to dividend or recommending an artificially low amount of dividend, would have consequences for all shareholders. Any shareholder in a company adopting the Model Articles or similar runs the risk that the directors will not

recommend the level of dividend that the shareholder wants. We see no reason why the risk of a possible dispute between directors of the Company and shareholders generally compels the interpretation that holders of B Shares specifically are entitled to have their dividend made payable automatically.

39. For those reasons, therefore, we consider that properly construed the Company's articles of association provide that all dividends, whether payable on the B Shares, or on any other class of share, can only become "payable" by following the routes set out in Article 30 of the Model Articles. Since those routes unambiguously involve "decisions" being taken by the Company, its shareholders and its directors it follows that the preferential right on the B Shares does fall within s173(2A).

40. We are reinforced in our conclusion by the view that, if the preferential dividend were to be paid in the automatic manner which the Company propounds, come what may, and whatever the then state of the company's finances might be, then it would have been made clearer in the Articles than by the, at best, equivocal drafting of Article 2.1. This is the sort of point which can, of course, be made in most disputes about interpretation or construction, but we think it has genuine force in the present case.

41. Those reasons are sufficient for the Company's appeal to be dismissed and make it unnecessary for us to consider the other reasons that the FTT gave for its decision or HMRC's other arguments for supporting the Decision. In particular, we do not need to address the argument that, even on the Company's case, the B Shares carried a right falling within s173(2A) since the very act of ascertaining Profits depended on "decisions" of the Company or other persons.

Disposition

42. The appeal is dismissed.

MR JUSTICE MANN

JUDGE JONATHAN RICHARDS

RELEASE DATE: 25 January 2021