TC01760

Appeal number TC/2010/06025

Enterprise Investment Scheme – Whether company engaged in "property development" – Whether money raised by share issue "employed" within statutory time limit – Richards & Skye Inns v HMRC [2011] UKUT B25 (TCC) applied – Appeal dismissed

FIRST-TIER TRIBUNAL

TAX

BENSON PARTNERSHIP LIMITED **Appellant**

- and -

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

TRIBUNAL: JOHN BROOKS (TRIBUNAL JUDGE)
DAVID EARLE (MEMBER)

Sitting in public at Keble House, Southernhay Gardens, Exeter, EX1 on 9 March 2011 with further submissions from the parties in December 2011

Martin Edhouse, consultant, LK Chartered Accountants for the Appellant

Simon Foxwell of HM Revenue and Customs, for the Respondents

DECISION

1. This is an appeal by Benson Partnership Limited (the "Company") against a decision by HM Revenue and Customs ("HMRC") to withdraw a claim for relief under the Enterprise Investment Scheme ("EIS") on the basis that the statutory eligibility conditions were not met by the Company.

Legislation

2. The applicable legislation is contained in the Income and Corporation Taxes Act 1988 ("ICTA") and the Taxation of Chargeable Gains Act 1992 ("TCGA").

3. Section 289 ICTA which is headed "Eligibility for relief" provides, insofar as is relevant to this appeal:

> *(1) For the purposes of this Chapter, an individual is eligible for relief, subject to the following provisions of this Chapter, if—*
>
> *(a) eligible shares in a qualifying company for which he has subscribed wholly in cash are issued to him and, under section 291, he qualifies for relief in respect of those shares,*
>
> *(aza) he subscribed for the shares (other than any of them which are bonus shares) wholly on cash,*
>
> *(aa) at the time they are issued the shares (other than any of them which are bonus shares) are fully paid up,*
>
> *(b) the shares (other than any of them which are bonus shares) are issued in order to raise money for the purpose of a qualifying business activity,*
>
> *(ba) the requirements of subsection (1A) below are satisfied in relation to the company,*
>
> *(c) at least 80 per cent of the money raised by the issue of–*
>
> *(i) the shares, and*
>
> *(ii) all other eligible shares (if any) of the company of the same class which are issued on the same day,*
>
> *is employed wholly for the purpose of the activity mentioned in paragraph (b) above not later than the time mentioned in subsection (3) below.*
>
> *(d) all of the money so raised is employed wholly for that not later than 12 months after that time.*
>
> *(2) …*
>
> *(3) The time referred to in subsection 1(c) above is–*
>
> *(a) the end of the period of twelve months beginning with the issue of the eligible shares,*

4. A "qualifying company" must, in addition to meeting the other requirements of s 293 ICTA, exist for the purpose of carrying on "one or more qualifying trades". A trade is a "qualifying trade" if it complies with s 297 ICTA. Section 297(2) ICTA provides that the trade must not at any time in the relevant period consist of one or more of the list of activities set out in the subsection (at paragraphs (a) to (g)) if that activity on its own or when taken together with another amounts to a "substantial" part of the trade.

5. One such activity included on the list is that of property development (s 297(2)(fa) ICTA). This is defined by s 298(5) ICTA as the development of land by a company "*which has, or at any time has had, an interest in the land*" with the "*sole or main object of realising a gain from the disposal of an interest in the land when it is developed.*"

6. In addition to income tax relief a person who subscribes for shares making a qualifying EIS investment is also entitled to capital gains deferral relief under schedule 5B TCGA provided the conditions contained in paragraph 1 schedule 5B TCGA are met. These conditions require at least 80% of the money raised by the shares to be "*employed*" by the company for the purpose of a qualifying business activity "*not later than the time mentioned in section 289(3)* [ICTA]" ie within 12 months from the issue of the shares (paragraph 1(2)(g) schedule 5B TCGA).

7. EIS relief may be withdrawn by HMRC under s 307(1A) ICTA and paragraph 1A(5)(b) schedule 5B TCGA where relief has been given but which has subsequently been found not to have been due.

Evidence

8. We heard oral evidence of Mr Howard Johnson, a director and the majority shareholder of the Company and were provided with documents which included:

(1) The accounts of the Company for the years ended 31 March 2005, 2006, 2007 and 2008;

(2) a Purchase Agreement (the "Agreement"), dated 17 April 2004, between the Company and Lebeau Construction Inc. ("Lebeau")" a Florida construction company under which Lebeau was employed by the Company to construct a residential building in Florida;

(3) a copy of an e-mail sent to Mr Johnson by Nikki Bakewell an employee of the Florida builder's agents on Monday 23 January 2006 which stated "please find attached picture that was taken last week" to which was attached a photograph of the exterior of what appears to be a substantially completed property (the "Florida Property") with walls and roof completed but without doors, window frames and windows; and

(4) a copy of an e-mail sent to Mr Johnson by Ms Bakewell on Friday 26 May 2006 requesting the third and fourth stage payments under the terms of the Agreement.

9. On the basis of this evidence we make the following finding findings of fact.

Facts

10. The Company was incorporated on 17 December 2002 to provide consultancy and advisory services to public and private sector organisations in relation to construction estimating, project management, quantity surveying and housing management services.

11. Its directors and shareholders are Mr Howard Johnson and his wife, Mrs Jill Marie Johnson.

12. In 2004 Mr and Mrs Johnson bought land in Florida. This came with planning permission to build a single story dwelling.

13. It was decided that the Company, which had no interest in the land, would manage and supervise the project. Mr and Mrs Johnson, as clients of the Company, agreed that they would pay the Company for the use of their time and expertise based on a rate of cost plus 5%. However, this agreement between Mr and Mrs Johnson and the Company was not reduced to writing neither was it recorded in any Company minutes.

14. On 17 April 2004 the Company entered into the Agreement under which Lebeau was to construct the Florida Property for $260,450 (approximately £170,000 at the exchange rate applicable at the time). Clause 2 of the Agreement provided for payment in stages as follows:

(1) 10% before construction commenced;

(2) 25% when “slab poured” (the floor completed);

(3) 25% when roof dried in;

(4) 25% when “drywall” hung;

(5) 10% when cabinets in; and

(6) 5% when a certificate of occupancy had been issued.

15. Although it was intended that construction of the property would start in July 2004 and be completed by about April 2005, Florida was hit by Hurricane Charley during August 2004. This resulted in all new and non-essential construction work being halted and diverted labour and materials to emergency repairs. In September 2005 Hurricane Katrina struck the west of Florida leading to further delays caused by shortage of materials and labour as necessary repairs were undertaken. As a result work on the property did not start until April 2005.

16. Although the work was not completely finished until April 2006, 85% of the construction had been completed by the week before 23 January 2006. However, despite being entitled to payments on completion of the various stages of construction Lebeau did not request payment until later and did not request the third and fourth stage payments until 26 May 2006 so that by this time only 60% of the price had been

requested even though, under the terms Agreement, Lebeau would have been entitled to 85% of the purchase price in the week before 23 January 2006.

17. The Company's involvement with the project was, through Mr Johnson, to liaise with the builders and monitor the construction on a week to week basis. This was mainly undertaken through emails and photographs although Mr Johnson did travel to Florida three or four time while the property was being built where he dealt with matters such as the design of the irrigation system and siting of internal windows and doors.

18. Mr Johnson had, on 17 December 2004, subscribed £86,000 for 86,000 £1 ordinary shares in the Company. On 5 January 2005 a claim for EIS relief was made. This was initially accepted by HMRC but withdrawn on 12 December 2006 on the grounds that 80% of the money raised by the share issue had not been employed within 12 months as required by the legislation. In subsequent correspondence, HMRC raised the question of whether the Company was engaged in property development, a non-qualifying trading activity for EIS purposes.

19. The Company's profit and loss accounts for the years ended 31 March 2005 and 31 March 2006 do not show any payments having been made in respect of the Florida Property nor does the balance sheet reflect any amount due under the stage payments. Although in the Company's Trading Profit and Loss Accounts for the year ended 31 March 2007 there is a reference to income of £94,500 from the sale of property this is not a reference to the sale of the Florida property (in which the Company had no interest) but payment by Mr and Mrs Johnson under their agreement with the Company.

Skye Inns Ltd & Christopher Richards v HMRC

20. Having reserved our decision, although it had not been brought to our attention by the parties, we became aware of the decision of this Tribunal in the case of *Skye Inns Limited and Christopher Richards v HMRC* [2009] UKFTT 366 (TC) TC00304 ("*Skye Inns*"). The issue in that case was described by the Tribunal (Judge Howard Nowlan and Elizabeth Bridge) at [1] in the following terms:

> "These appeals both depended on the one seemingly simple question of whether the Appellants could demonstrate that Skye Inns Limited ("Skye") had "employed" 80% of the cash contributed to it, when Mr Chris Richards ("Mr Richards") subscribed share capital in the company on 18 December 2001, in Skye's qualifying trade within the twelve-month period from the date of subscription, in other words by 17 December 2002."

The Tribunal concluded at [22] finding that:

> "The only realistic approach is to treat funds raised in the share issue as having been "employed in the business" only when actually spent on realistic net increases to the net trading assets or when reserved to **supplement the current receipts of the trade**, either in funding losses

> or meeting expenses that can be ranked as "current business requirements".”

In that case 80% of the funds raised by the share issue in that case had not been spent or “employed” in the business and the appeal was dismissed.

21. However, the Appellant in that case did not accept the decision of the Tribunal but appealed to the Tax and Chancery Chamber of the Upper Tribunal. As a decision of the Upper Tribunal is binding on us we did not consider it proper to determine the present case until such time as the Upper Tribunal released its decision in *Skye Inns*.

22. On 8 November 2011 the Upper Tribunal (Sales J) released its decision in *Skye Inns* (reported at [2011] UKUT B25 (TCC)) concluding at [27-29] that:

> [27] “… In my judgment, the approach of the Tribunal was correct as a matter of law and its application of the law to the facts of the case cannot be faulted.
>
> [28] The word “employed” in paragraph 1(2)(g) of schedule 5B and section 289(1)(c) of the Taxes Act is not defined in the legislation. In my view, it is a word which requires the money in question to be used in some way for the purpose of carrying on the qualifying activity within the relevant one year period. Clearly, if the moneys are spent in carrying out the qualifying activity in that period, they will have been “employed” for the purposes of that activity; but, as the Tribunal correctly recognised, the concept of being “employed” for the purpose of an activity extends more widely than this.
>
> [29] Moneys will also be “employed” for the purpose of an activity if the company has earmarked them in the relevant period for some specific purpose (which does not necessarily have to be a purpose calling for expenditure in that period) and is keeping the reserve for that purpose. In such a case, the company may be found to have “employed” the moneys for that purpose within the relevant period. Whether moneys have been notionally set aside with sufficient precision for a specific purpose so that they can be said to have been “employed” for the purpose of a qualifying activity at the time they are notionally set aside will be a matter for assessment by a tribunal on the particular facts of an individual case.”

23. In order for us to deal with the present case fairly and justly as required by the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009, we directed that the parties could, if so advised, make further representations in the light of the decision of the Upper Tribunal in *Skye Inns*.

24. Both parties have chosen to avail themselves of this opportunity and we were provided with written submissions from the LK Partnership on behalf of the Company and from Mr Mike Faulkner of HMRC on 30 December 2011.

Submissions

25. At the hearing Mr Edhouse, for the Company, accepted that 80% of the money invested by Mr Johnson had not been spent but contended that "spent" was too narrow a construction of "employed".

26. He referred to the contractual obligation of the Company to pay Lebeau submitting that it "is certain [from the photograph attached to the 23 January 2006 email] that sufficient work had been undertaken by 17 December 2005 (about three weeks prior to the picture) to have merited the issue of a draw down (a stage payment request) by the builders or their agents" which would have amounted to 85% of the purchase price.

27. It therefore followed that the Company was, at 17 December 2005, effectively liable to pay the amount due on demand, indeed it could not employ it elsewhere without risk of severe financial embarrassment at best and legal action for recovery of moneys owed at worst.

28. The further submissions on behalf of the Company refer to a dollar account having been established for the specific purpose of paying the contractor. We were provided with a copy of a letter, dated 13 January 2005, from the National Westminster Bank to the Company confirming that £86,000 was transferred into a dollar account on that date. It is submitted that this demonstrates that there was both a specific earmarking of funds in the currency in which the liability existed and an acknowledgement that there was a liability as there was no other purpose for which the dollar funds could have been used.

29. For HMRC, Mr Foxwell submitted that the Company failed to qualify for EIS relief on two counts, first 80% of the investment was not "employed" within 12 months contending that it was not sufficient to earmark moneys for ultimate expenditure and secondly that the Company was engaged in property development but that even if this was not the case there was not sufficient evidence that it was carrying on a qualifying activity.

30. In their further submissions, in the light of *Skye Inns*, HMRC now accept that if the equity capital raised by the Company was earmarked and set aside for a specific purpose that formed part of its qualifying activity the money raised would have been "employed".

31. However, it is contended that the Company had neither spent the money nor earmarked it for a specific purpose as it is not shown as an expense in the profit and loss account and, as the Florida Property was owned by Mr and Mrs Johnson, is not shown as an asset in the balance sheet. As such HMRC submit that as it does not own the Florida Property, the liability to make stage payments is not the Company's but that of the owners, Mr and Mrs Johnson.

32. It is therefore submitted that these payments cannot be said to be for the purposes of a qualifying trade carried on by the Company as the money was simply passing through it. As the Agreement is between Lebeau and Mr Johnson on behalf of the

Company to enable the Company to make payments on the Johnson's behalf, even if the moneys have been "employed" by being earmarked for a specific purpose it does not satisfy the test set by Sales J in *Skye Inns* as it was not employed by the Company.

33. It is suggested, in the further submissions made on behalf of the Company, that "it would not have been inappropriate for an accrual to have been made for the liability to pay the contractor as the liability had been established. In this case at least 80% of the work had been done by the contractor and therefore the liability existed. The effect of this would have been to also increase the assets of the Company and ultimately the profit."

Discussion and Conclusion

34. Given that the Company did not at any time have an interest in the Florida property we find it was not engaged in the non-qualifying activity of property development. Section s 298(5) ICTA is clear that for the purposes of s 297(2)(fa) ICTA, which excludes it from EIS relief, that "*property development*" is the development of land by a company which "*has or at any time has had an interest in the land*".

35. It is common ground that 80% of the funds raised by the share issue on 17 December 2004 were not spent within 12 months. However, as Sales J said, in *Skye Inns*, that moneys will be "employed" for the purpose of an activity if they have been earmarked in the relevant period for some specific purpose, we have to determine whether at least 80% of the moneys was either spent or earmarked by the Company for payment for the construction of the Florida Property within 12 months of the investment by Mr Johnson.

36. We accept Mr Edhouse's submission that, under the terms of the Agreement, the Company (and not Mr Johnson) was liable to pay Lebeau on completion of each stage in the construction of the Florida Property. Therefore, once a stage had been completed the Company was required to pay the amount due on demand and could not use that money elsewhere. As such, once a stage payment became due that money was earmarked for that purpose irrespective of any request for payment by Lebeau. However, until that time the funds could have been used for any purpose and we do not therefore accept, as contended for the Company, that the creation of a dollar account in January 2005 amounted to the earmarking of those sums sufficient to constitute their employment for a specific purpose, either at that time or later.

37. Also, we do not agree with Mr Edhouse that it is "certain", from the photograph attached to the 23 January 2006 e-mail, that sufficient work had been undertaken by 17 December 2005 for the funds to have been committed or earmarked by that date even if allowance is made for Christmas and New Year holidays. In our view the only inference that can be drawn from the photograph is that 85% of the construction had been completed by the week before 23 January 2006.

38. In addition we note that in the accounts to 31 March 2006 there was no recognition of any obligation to pay further sums for the construction of the property

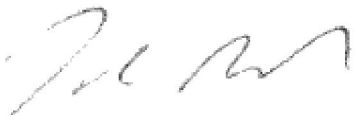
by way of an accrual or otherwise notwithstanding that it was submitted, on behalf of the Company, that "it would not have been inappropriate for an accrual to have been made…"

39. As such, it cannot be established that the money raised by the share issue was committed or earmarked and therefore employed for a specific purpose within 12 months from the date of the investment as required by the legislation and the appeal cannot succeed.

40. In the circumstances it is not necessary for us to consider HMRC's argument that the liability to make the stage payments was that of Mr and Mrs Johnson as owners of the Florida Property and that the Company was a merely a conduit to enable these payments to be made although we note that it did not appear to reflect the existence of the separate legal personality of a company which is different from its directors (*Salomon v A Salomon & Co Ltd* [1897] AC 22).

41. We therefore dismiss the appeal.

42. 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.



JOHN BROOKS

TRIBUNAL JUDGE
RELEASE DATE: 18/01/2012