TC04188

Appeal number: TC/2013/04742

Income tax – relief for loss on disposal of shares in a qualifying trading company – s.574 ICTA – whether the relevant company satisfied the "qualifying company" test in s.293 ICTA – whether the company existed throughout the relevant period wholly for the purpose of carrying on one or more qualifying trades – identification of "relevant period" – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

IAN BRANAGAN **Appellant**

-and-

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

TRIBUNAL: JUDGE KEVIN POOLE
MISS SANDI O'NEILL

Sitting in public at 45 Bedford Square, London on 28 May 2014

Robert Maas of CBW Blackstone Franks for the Appellant

John Helm, Presenting Officer of HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This appeal concerns the availability to the appellant of income tax relief under section 574 Income and Corporation Taxes Act 1988 ("ICTA") (since re-written in Chapter 6 of Part 4, Income Tax Act 2007) on a "negligible value" deemed disposal of shares in a company.

2. The point at issue is whether the relevant company, Intelligent Risk Limited ("IR"), satisfied the "qualifying trading company" test in subsection 576(4) ICTA which, in turn, depends upon whether it satisfied the requirements to be a "qualifying company" set out in section 293 ICTA.

3. HMRC do not dispute that the bulk of the requirements of that section are satisfied. The particular point in issue is whether IR existed "throughout the relevant period... wholly for the purpose of carrying on one or more qualifying trades…" for the purposes of subsection 293(2) ICTA in the light of its particular activities and intentions. The key question, as presented by the parties at the hearing, was whether the activities and intentions of IR were such that its intended trade could be said to include, in substantial part, "money lending… or other financial activities" as referred to in the definition of "qualifying trade" in subsection 297(2)(c) ICTA. In fact, there was a further issue lurking behind that question, namely the identification of the "relevant period" during which the relevant "purpose" test had to be satisfied.

The facts

Introduction and basic history

4. We received a bundle of documents in evidence and, on behalf of the appellant, witness statements of the appellant himself, Paul Varcoe (former chairman of IR) and Anthony Flynn (another shareholder in it). We also heard oral testimony from the appellant, Mr Varcoe and Mr Flynn. There was a short agreed statement of some of the core uncontroversial facts.

5. The only person who was at any time a director of IR and who gave evidence in the appeal was Mr Varcoe and, as mentioned below, his role was non-executive (though, as chairman from October 2002 until at least October 2006, he still took part in negotiations on behalf of IR during its various attempts to launch itself). We therefore had to rely to a large extent on the documentary evidence to glean an understanding of the intended business of IR at the various relevant times during its existence. It is fair to say that Mr Varcoe did sign a number of the relevant documents and we accept that he attended most board meetings, though he also said he did not get involved with the approval of IR's audited accounts in any detail, which concerned us somewhat.

6. On the basis of the above evidence, we find the following facts.

7. IR was incorporated on 20 December 2000. Its accounts for the period up to 31 December 2001 disclosed no turnover or expenses, only issued share capital of £100.

8. IR started its activities in earnest in early 2002, following an initial fundraising exercise which was presumably in train during 2001. IR was used as the vehicle for exploiting an idea conceived by one Jocelyn ("Joss") Wood (a founding director and shareholder of IR and a former army officer) for the creation of a sophisticated financial product called an "income bonded loan". The details of the product are not material, but its key features were that it provided for the possible creation of residential property mortgages on which the borrower's periodic payments, instead of being fixed by external interest rates, were fixed by reference to his or her employment income as it changed over time. This basic idea had been worked up into a detailed financial product (including a structure for securitising the mortgages in a form acceptable to the market), backed up by sophisticated financial modelling and IT support, to the extent that at least one patent had been obtained in Australia following a patent application initiated by Mr Wood in February 2000. Unfortunately Mr Wood was not available to give evidence.

9. The appellant became a shareholder in IR in October 2002, following an introduction from Mr Varcoe, a previous colleague of his, who himself invested and became non-executive chairman of IR at the same time. At no time was the appellant a director of IR or involved in its business, other than in his capacity as a shareholder. Mr Varcoe had, following a career as a financial futures and options trader, earlier promoted an extremely successful software company (in which the appellant had not invested due to other commitments at the time) which provided software to the financial sector and the appellant had great respect for Mr Varcoe's financial acumen; as he put it, "he could have come to me with an idea for chocolate teapots and I would still probably have invested".

10. The appellant invested a total of £50,459.67 in 55 A Ordinary shares of 5p each in IR on various dates from 8 October 2002 to 7 August 2004, as follows:

Date of subscription	**Number of shares**	**Price per share**	**Amount subscribed**
8 October 2002	20	£1,250	£25,000
12 December 2003	4	£2,500	£10,000
13 February 2004	27	£202.21	£5,459.67
7 August 2004	4	£2,500	£10,000
		Total	£50,459.67

The activities and intended business of IR

11. For reasons that will become apparent below, the way in which it was intended, throughout its period of operation, that IR would turn Mr Wood's idea to account is highly relevant. In particular, the parties are (in broad terms) agreed that the question of whether IR's purpose was (a) to enter the mortgage market as a lender in its own right (albeit with funding provided by external financial institutions) or (b) to license the intellectual property rights and systems in its "income bonded loan" concept to third party lenders (whether with or without the provision of the associated "back office" support), is crucial. We therefore examine this issue in more detail as follows.

12. The available evidence of IR's activities and the purposes for which it existed is sketchy. Given that IR itself was dissolved on 20 January 2009 and its records are largely unavailable, this is not surprising, especially as neither its Chief Executive nor its Chief Operating Officer were available to give evidence. There are however a number of surviving documents which cast a reasonable light on events.

13. In Mr Varcoe's witness statement, he said that:

> "We did consider some kind of joint venture with an existing mortgage provider. Such a joint venture would not have involved our entering the mortgage market though…. When we were exploring our options, we did briefly[1] discuss the possibility of ourselves granting mortgages. However we raised only £4.6 million from investors and all of this was spent developing the product. Accordingly there was no realistic possibility of Intelligent Risk itself granting mortgages. A company would need funds of hundreds of millions to enter the mortgage market, plus a marketing budget of multiple millions. We never had that sort of money. Neither did we have the ability to raise it. It was a wholly fanciful idea that we looked at because we were looking at all of the possible ways to exploit the platform, and because it was a dream to be sold."

14. All three witnesses for the appellant effectively stated (in one way or another) that they considered they were getting involved in a computer software company rather than a mortgage lender. We consider their evidence to have been somewhat coloured by hindsight and only Mr Varcoe had any involvement in the management of IR. We therefore consider the picture that emerges from the documents to be more reliable.

15. In IR's audited accounts for the calendar year 2002:

(1) Its "Principal activities" were described in the Directors' Report as follows:

[1] In oral evidence, Mr Varcoe explained his use of the word "briefly" as meaning that granting of mortgages was discussed "as one of a number of possibilities", and not just "as a passing thought".

> "The Principal activity of the company will be to act as a provider of residential mortgages."

(2) The Directors' "Business review" stated:

> "The company is currently undertaking a process of developing an innovative mortgage product which it intends to market for the first time during 2003…"

(3) IR was shown as having raised some £2.5 million by an issue of shares, having spent some £300,000 on "administrative expenses", some £95,000 on fixed assets (including £35,000 on buying Mr Wood's patent rights), but having generated no sales.

(4) Messrs Wood and Varcoe were shown as directors, along with R.G. Hiles, P.I Shama and K.P. Smith. From other documents before us in evidence, we see that Mr Shama (described as "Chief Operating Officer") was a very experienced senior executive with a track record of running residential mortgage operations, in particular with Household Mortgage Corporation and Nationwide Building Society. Mr Smith (described as "Chief Technical Officer") had extensive IT experience in the financial services sector, including having worked with Mr Varcoe.

16. In IR's audited accounts for the calendar year 2003 (signed on 26 January 2004), Messrs Wood, Varcoe, Shama and Smith were still shown as directors; IR's "Principal activities" and "Business review" were in exactly the same terms as the previous year (except that the target launch date for the product was now stated to be 2004 rather than 2003); the administrative expenses for the year increased to some £1.9 million (with no sales reported), though a further share issue had raised some £1.3 million; and its employee numbers including directors had increased from 4 to 12 during the year.

17. During correspondence with HMRC in July 2004 about R&D allowances for 2002, IR's advisers KPMG stated that:

> "Intelligent Risk Ltd, **as a mortgage lender** (*emphasis added*), is for the purposes of VAT partially exempt. As such the company may only recover 5% of its input VAT incurred from Customs & Excise."

18. IR had been negotiating with various large institutions to obtain equity and loan funding, and it seems that in the summer of 2004 it received an indication that UBS group was prepared to invest. In a short circular letter to IR's shareholders dated 11 June 2004, Mr Varcoe said:

> "I can now tell you the excellent news that one institution has made an offer to take a minority stake and will provide enough funding to ensure **the company can launch and securitise its products**." *(emphasis added)*

19. The structure of the investment was to be a smallish (though still significant) equity investment in IR itself and the provision of a much larger "warehouse facility", ideally of £500 million (effectively a source of funds for lending on to actual mortgage borrowers).

20. Work on the development of the product continued, and in a further letter to shareholders from Mr Wood, the Chief Executive, dated 7 July 2004, reference was made to the fact that IR had received:

> "…initial feedback from Moody's, Fitch and Standard & Poor's. Their credit committees have stated that they would expect c90% of our mortgage backed securities to be issued with a AAA/Aaa rating. This is excellent news, and should mean that we can complete the private equity and warehouse facility agreements quickly."

21. In late September 2004, a further letter to shareholders from Mr Wood included the following passage:

> "You will recall that the FSA *[Financial Services Authority]* will be responsible for regulating the mortgage industry from 31 October 2004. We have spent considerable efforts in ensuring that we will be fully compliant with all regulatory requirements, and following an inspection visit on 27 August, we were given the key document which is known as the "Minded to Authorise" letter. This sets out five conditions which we need to satisfy before receiving our full authorisation, primarily they relate to receiving the investment from our backer and ensuring that our operational systems are audited to ensure that they work as we expect. The whole Company worked extremely hard to secure this result, there were many fewer conditions than we expected, and those that were listed are not onerous. **You will realise that as a new lender with a radically different customer proposition** we were inspected with more than the usual rigour…" *(emphasis added)*

22. Suddenly and unexpectedly, on 15 November 2004, UBS withdrew from negotiations with IR. In a circular email to shareholders on 18 November 2004, Mr Wood informed the shareholders of the steps the directors were taking in the light of this unwelcome development. This included the raising of £250,000 by a share issue, in order to buy time to achieve **"either a sale of the company, or a sale or licensing of the company's main product…".** *(emphasis added)*

23. UBS's withdrawal prompted attempts to secure another investor. IR prepared a lengthy document (121 pages) in the nature of a prospectus which was issued shortly after 14 January 2005. The purpose of the document was clearly to support IR's efforts to replace UBS with a new funder. It casts further light on what IR's plans were, up to that time. In the "Executive Summary", IR's "Strategy" was stated in the following terms:

> "Over the last 18 months the Company's *[sic]* has been developing the IT systems and infrastructure to launch as a standalone mortgage lender.

> It is now seeking the funding launch *[sic]* the product and to take the Company to profitability."

24. The remainder of the document went on to make it clear that IR was, at that time, still contemplating the possibility of itself acting as direct lender to the ultimate borrowers. There was an entire section in the document setting out how IR proposed to finance its lending initially through "warehouse lines" of finance, ultimately securitising the mortgages for sale to investors in order to provide longer term finance. It went on to explain that it was envisaged that "Warehouse line providers have recourse to Intelligent Risk for the full value of their lending, whereas bondholders do not." In the same section, IR was referred to as "the originator of the mortgages" and described how "mortgages sold by Intelligent Risk into a securitisation will typically only be a few months old". In another section of the document examining financial sensitivities, it was stated that if IR was unexpectedly successful, "then the Company would be likely to partner with another lender possibly by way of a technology licensing agreement." This, however, was in the context of IR expanding rapidly to achieve a 4% market share and "this level of sales would outperform competitors like Alliance and Leicester and has to be considered unlikely".

25. In IR's audited accounts for the calendar year 2004 (signed on 31 March 2005), the "Principal activities" were stated in the same terms as in previous years. Under "Business review", it was now stated that IR:

> "… has been unable to raise sufficient funding to market the product during the year. The company is continuing its attempts to raise finance but has had to make the majority of its staff redundant at the year end in order to control costs".

26. The directors remained the same as in 2003. Having incurred further administrative expenses of some £2 million without generating any sales, the accounts showed that, although IR had raised an additional £480,000 of share capital during 2004, it had largely run out of cash by the end of 2004.

27. From a circular letter dated 21 June 2005 from Mr Wood to the shareholders of IR (updating them on a number of the negotiations it was engaged in), it appears that it was still IR's intention at that time, if it could be achieved, to establish itself as a mortgage lender in its own right, with financial backing from some other institutional investor at least one of which was considering a structure along the lines of that which had previously been under discussion with UBS. It was however stated in this letter that "our current funding will only last until the end of July", after which it was said there were three options, which could be summarised as follows: (i) raise more money to try to buy time to crystallise discussions with one of the parties named or unnamed in this letter or for another deal to be put in place; (ii) try to reach an accommodation with creditors, close the office and cut overheads to near zero in an attempt to keep IR alive, then continue to pursue the outstanding opportunities whilst the remaining personnel sought other employment in parallel; and (iii) put IR into liquidation "or into the hands of an insolvency practitioner".

28. The picture after that time becomes less clear. The attempts to bring another large institution on board were obviously unsuccessful, and IR appears to have accepted that its original plans to enter the mortgage market as a lender were doomed.

29. Included in our bundles was a copy of an article in the August 2005 issue of "Mortgage Finance Gazette" in which the product was explained and generally promoted and it was stated that IR (under its trading name "Neos Financial") was "ready to enter into partnerships with interested lenders, probably on a white-label basis" (i.e. presumably where the third party lender would rebrand the mortgage as its own product). At a meeting with HMRC on 9 September 2005, Mr Wood explained that IR's original intention had been to establish itself as a mortgage provider in its own right; it had hoped to raise £500 million through UBS for "onward lending" but was now negotiating a "joint venture licence agreement" under which it would receive a payment of £150 for each income bonded loan mortgage set up using its system.

30. From this, we infer that IR had by the end of July 2005 effectively abandoned any hope of establishing itself as a mortgage lender (its funding having been exhausted). Thereafter it was considering other ways of securing value for its shareholders, including (a) licensing the product to an existing mortgage lender (whilst running the IT platform and administrative support itself), (b) securing some kind of income stream from a sale or licence of the product, with IR having less (or no) active involvement in running the IT platform and administrative support, and (c) an outright sale of the company itself or its intellectual property.

31. Unfortunately these ideas came to nothing. Mr Smith resigned as a director in November 2005 and Mr Wood resigned in May 2006, leaving only Mr Varcoe and Mr Shama involved with IR. No accounts were produced for 2005. On 29 September 2006, Mr Shama wrote to HMRC "to advise that the above company is not trading and will not be submitting a return." He went on to say:

> "The circumstances of the company are that it was a start up company. We were trying to launch ourselves as a mortgage lending company. We raised some funds which were being used to build the infrastructure of the company whilst we tried to raise the larger funds that would be needed to launch ourselves. Unfortunately we were unable to raise the necessary funds…"

32. Finally, on 19 October 2006, Mr Varcoe and Mr Shama wrote to the shareholders to inform them that "attempts to try to find a deal" had failed and therefore they had concluded it was "time to wind up the company". They explained that although IR owned intellectual property it was of little or no value as it "consisted of unfinished software, spreadsheets and basic know how to the extent it has been documented". They hoped to wind IR up voluntarily if negotiations with the final creditors and the sale of the "few **remaining** assets" *(emphasis added)*, which were valued at £1,470, were successful but that there would be no funds for distribution to shareholders.

33. Included in our papers was a copy of an invoice numbered 00001/07 and dated 11 July 2007 for the sale by IR to a company called "Varsity Anabasis Limited" of

"Software as agreed in contract dated July 2007" for £2,000. This appears to represent the last stage of a realisation of its assets.

34. On the basis of the evidence summarised and findings set out above, we conclude that:

(1) from its earliest stages in 2002, IR's purpose was to establish (if it could) a trade in which it would itself offer residential mortgages to the public;

(2) over time, that purpose became more detailed, including the intended financing arrangements (short term financing for the loans through a "warehouse facility" with a major financial institution, with the mortgages then securitised and sold on to investors to repay the warehouse facility provider and/or provide further funds for lending);

(3) following the withdrawal of UBS in November 2004, IR started seriously to consider alternative methods of deriving value from its product, whilst still making attempts to rescue its original plans;

(4) around the end of July 2005 IR finally abandoned any hope (and, with it, any purpose) of becoming a mortgage lender in its own right, instead focusing its efforts on rescuing some value for its shareholders from its product by other means, as referred to at [30] above;

(5) with Mr Wood's resignation in May 2006, IR was, at least by then if not earlier, no longer capable of any significant activity beyond simply closing down its affairs in an orderly manner, which it then did;

(6) IR had never actually reached the stage of commencing any trade, though until around the end of July 2005 it had existed wholly or mainly for the purpose of carrying on a trade as a mortgage lender in its own right.

35. In reaching the conclusions we have at [34(1)], [34(2)] and [34(6)] above, we should say that we have rejected a submission of Mr Maas summarised at [58] below.

The appellant's claim for relief

36. The business of IR having failed, the appellant's shares in it became worthless. The appellant claimed in his 2005-06 tax return (submitted on 28 January 2007) that a deemed "negligible value" disposal of the shares had taken place on 5 April 2006, and HMRC accepted this claim; consequent upon this disposal, he claimed to set the capital loss so arising against his income for the tax year 2004-05 under section 574(1)(b) ICTA. The question before us is whether he is entitled to do so.

The law

37. The statutory provisions governing the relevant relief are very complex. Because the scope of the dispute between the parties is focused around one particular part of those provisions, we do not consider it would be helpful to set out the

provisions in full in the body of this decision. We set out necessary extracts from the relevant provisions in an Appendix to this decision.

38. In 2005-06, the relief in question arose (if at all) under section 574 ICTA in the following circumstances:

> "…[w]here an individual who has subscribed for shares in a qualifying trading company incurs an allowable loss… on the disposal of the shares…"

39. The parties are agreed that in this appeal, the appellant was an individual who subscribed for shares in IR and he incurred an allowable loss (under section 29 Taxation of Chargeable Gains Act 1992) on the deemed disposal of those shares on 5 April 2006. The only difficulty arises over the question of whether they were shares in "a qualifying trading company".

40. The phrase "qualifying trading company" was, at all relevant times, defined by subsection 576(4) ICTA (the full text of which, as in force at the relevant time, is set out in the Appendix to this decision).

41. It is worth observing in passing that whilst the apparent natural interpretation of the main relieving provision (subsection 574(1) ICTA, see the Appendix) would require that the company in question should be a "qualifying trading company" *at the time of the share subscription*, section 576 ICTA makes it clear (by the very specific way in which it defines "qualifying trading company" – see below) that this is not the case.

42. From the definition of "qualifying trading company" in subsection 576(4) ICTA, it can readily be seen that there are three requirements to be satisfied before a company will be a "qualifying trading company". In broad terms, these are that:

(1) the company was an "eligible trading company" at a particular point in time (subsection 576(4)(a) ICTA);

(2) the company was an "eligible trading company" for a period leading up to that time (subsection 576(4)(b) ICTA); and

(3) the company has carried on its business wholly or mainly in the United Kingdom throughout the "relevant period" (subsection 576(4)(c) ICTA).

43. The third requirement (in subsection 576(4)(c) ICTA) is not an issue in the present case – HMRC accept that, whatever IR's business was, it was carried on wholly in the United Kingdom at all times.

44. But there is a dispute as to whether the first two requirements (in subsections 576(4)(a) and 576(4)(b) ICTA) are satisfied. These requirements call, in broad terms, for an examination of the company's status as an "eligible trading company" (i) at a point in time and (ii) during a period leading up to that point in time.

45. Considering first the "point in time" requirement contained in subsection 576(4)(a), this is satisfied if the company was an "eligible trading company" on the date of the relevant disposal of shares (5 April 2006 in this appeal); but if it was not, then the requirement is still satisfied if the company had ceased to be an "eligible trading company" not less than three years before that date, and has not, since the time of such cessation, been an "excluded company", an "investment company" or "a trading company that is not an eligible trading company".

46. Turning to the "period of time" requirement in subsection 576(4)(b), this considers the period of time leading up to the date of disposal (or the earlier cessation of the company's "eligible trading company" status as referred to at [45] above). If the company was an "eligible trading company" for a continuous period of six years leading up to the relevant "point in time" determined under [45] above, then it fulfils the "period of time" requirement. But it will still satisfy that requirement if it was an "eligible trading company" for less than six years but had not previously been an "excluded company", an "investment company" or "a trading company that is not an eligible trading company".

47. Fortunately, in the present case, HMRC have not sought to argue (nor does it appear to us) that IR was at any time an "excluded company", an "investment company" (both as defined in subsection 576(5) ICTA, included in the Appendix) or a "trading company that is not an eligible trading company" (the phrase "trading company" being defined in the same subsection), so we do not explore those avenues any further.[2]

48. This somewhat simplifies the application of the tests in subsections 576(4)(a) and (b) in the present case. To satisfy the "point in time" requirement, IR would have to have been an "eligible trading company" at 5 April 2006 (being the date of the appellant's disposal) or it would have to have ceased being one no earlier than 5 April 2003. To satisfy the "period of time" requirement, it would only have to have been an "eligible trading company" for a continuous period of time (however short) up to the point in time by reference to which it satisfied the "point of time" requirement (i.e. 5 April 2006 or the earlier date on which it ceased to be an "eligible trading company").

49. In order to apply these tests, it is necessary to determine whether (and if so, when) IR satisfied the requirements to be an "eligible trading company". This phrase is defined in subsection 576(4A) ICTA (relevant extracts from which, for the purposes of this appeal, are set out in the Appendix). Unhelpfully, this is done by reference to yet another provision, section 293 ICTA, as follows:

> "(4A) A company is an eligible trading company for the purposes of subsection (4) above at any time when, or in any period throughout which, it would comply with the requirements of section 293…"

---

[2] IR clearly fell outside the definitions of "investment company" and "excluded company"; and as it never commenced any trade, it never reached the point where its business consisted "wholly or mainly of carrying on of a trade or trades" for the purposes of the definition of "trading company" in subsection 576(4).

50. Section 293 ICTA, so far as relevant for present purposes, is set out in the Appendix. The key part of section 293 refers us on to yet another concept, that of the "qualifying trade", by providing as follows:

> "293. – Qualifying companies
>
> (1) A company is a qualifying company… if it complies with the requirements of this section.
>
> ….
>
> (2) The company must, throughout the relevant period, be –
>
> > (a) a company which exists wholly for the purpose of carrying on one or more qualifying trades or which so exists apart from purposes capable of having no significant effect (other than in relation to incidental matters) on the extent of the company's activities…
>
> …"

51. The definition of "qualifying trade" is to be found in section 297 ICTA (relevant parts of which are set out in the Appendix). The key parts of that provision in this appeal are as follows:

> "(1) A trade is a qualifying trade if it complies with the requirements of this section.
>
> (2) …. the trade must not at any time in the relevant period consist of one or more of the following activities if that activity amounts, or those activities when taken together amount, to a substantial part of the trade –
>
> > (a) ….
> >
> > (c) banking, insurance, money-lending, debt-factoring, hire-purchase financing or other financial activities;
>
> …"

52. So, to summarise the structure of the relevant parts of the provisions that apply in this case:

(1) relief is only available if the investee company is a "qualifying trading company" (section 574 ICTA);

(2) a company will only be a "qualifying trading company" if it was an "eligible trading company" at a particular point in time and for a continuous period leading up to that point in time (subsections 576(4)(a) & (b) ICTA);

(3) a company is only an "eligible trading company" at a point in time, or during a period when, it is a "qualifying company" (subsection 576(4A) ICTA);

(4) a company is only a "qualifying company" if, throughout the "relevant period" (see below), it exists wholly for the purpose of carrying on one or more "qualifying trades" (disregarding, broadly, incidental purposes) (subsection 293(2) ICTA); and

(5) most trades carried on during the relevant period (except those in the proscribed list) will be "qualifying trades" (section 297 ICTA).

53. We consider in more detail below the meaning of the phrase "relevant period" as used in sections 293 and 297.

Submissions of the parties

Submissions for the appellant

54. Mr Maas submitted as follows. After outlining the law (which he said was agreed), he submitted that the "relevant period" over which we were required to consider the purpose of IR's existence was the period "starting 12 months before Mr Branagan made his investment and ending with his negligible value claim" (which he later refined as meaning "ending on 5 April 2006, the appellant's date of disposal"). He cited subsection 576(5) ICTA as authority for this.

55. He then sought to persuade us that the evidence showed that IR existed throughout that period "for the purpose of carrying on a trade of developing and exploiting a computer program" rather then a trade of carrying on "other financial activities" as a mortgage lender. As such, its intended trade was not a proscribed activity even if the program was designed to facilitate the provision of financial services.

56. In considering the "purpose" of IR, he referred to *Ian Flockton Developments Limited v Customs & Excise Commissioners* [1987] STC 394. In that case, a manufacturer of plastic mouldings and storage tanks bought and maintained a racehorse. It claimed to have done so effectively in order to promote the business, and therefore claimed to recover the VAT incurred in doing so. Such recovery was permitted if it was established that the goods and services on which it was charged VAT were "used or to be used for the purpose of any business carried on" by it. In considering the taxpayer's appeal, the High Court considered the nature of the "purpose" test and concluded that it was a subjective test, so that the tribunal had to look into the mind of the taxpayer (or, where the taxpayer was a company, the minds of the persons who controlled the company) at the relevant time to discover its (or their) purpose in purchasing the goods or services in question. Once that purpose had been established, it was irrelevant whether it was misconceived by reference to any objective standards.

57. Mr Maas acknowledged there was not a great deal of evidence available as to what IR's purpose or intention was, but he submitted there was sufficient for us to find that its purpose was to develop and exploit a computer program, rather than to establish itself as a mortgage lender. He referred to a number of specific factors which he considered supported this view:

(1) Mr Varcoe was predominantly a software developer, having successfully developed and brought a trading platform for the financial services sector to the market. Mr Shama was the only director with a background in mortgages;

(2) The original patent application contained some wording which suggested it was intended to be made available to retailers of financial products rather than used to compete with them;

(3) In correspondence with HMRC in 2004 in relation to a claim by IR for research & development tax credits, KPMG explained that the residential mortgage product being designed by IR was only the first of a suite of intended products using the technology (for which various international patent applications had been lodged) – all of which was inconsistent with the suggestion that IR was simply proposing to establish itself as a mortgage lender in the UK;

(4) The appellant and Mr Flynn invested in IR as an IT not a financial services business on the back of Mr Varcoe's track record in developing software for the financial services sector;

(5) In a letter to HMRC in June 2005, Mr Wood had said that IR had only finalised its theoretical work after two years of research and development in November 2004 and it was only then that they would know whether "what we were trying to achieve was physically possible";

(6) He also referred to various other correspondence to HMRC from Mr Varcoe and Mr Wood which contained statements about the intended business of IR but as these were all written after the essence of the dispute between IR and HMRC was clear, we do not consider them to be of much assistance.

58. Mr Maas also sought to persuade us that we should disregard as "pie in the sky" any suggestion that IR's real purpose was to establish itself as a mortgage lender. As he put it, something can only be called a purpose if it is capable of being achieved. Mr Varcoe said in evidence that IR would have "loved" to become a mortgage lender in its own right, and agreed that it was theoretically possible (and would have been the most profitable way to exploit its intellectual property, at least in the UK) but said that by the time it had spent the £4.6 million it had raised entirely on developing the product, there was no realistic possibility of IR itself granting mortgages. He also said in evidence that "it does not cost much money" to obtain the FSA's "Minded to Authorise" letter. We reject these submissions. We believe that obtaining FSA approval and the arrangements with Moody's would have been time consuming and rigorous and not entered into lightly. We also consider there is ample evidence that

IR's original purpose was to establish itself as a mortgage lender in its own right and the fact that such a purpose might be regarded as ambitious (even to the point of being "pie in the sky") is entirely irrelevant on the basis of *Ian Flockton Developments.*

Submissions for HMRC

59. Mr Helm submitted as follows. As he characterised it, the dispute was about whether IR was a qualifying trading company. He made no submissions on the subject of what was the "relevant period" for the purposes of this test, though his skeleton argument did state that one of the "points at issue" was "whether the intended trade changed from that of an excluded trade to a qualifying trade prior to the deemed disposal of the shares", and he also accepted that if we found its intention changed, such that it existed wholly for the purpose of carrying on a qualifying trade before it was wound up, then it would not be disqualified from relief by reason of an earlier abortive intention to carry on a non-qualifying trade. Somewhat disconcertingly, therefore, he was putting forward a less restrictive interpretation of the legislation than Mr Maas; but even in the light of that less restrictive interpretation, he submitted that IR failed the "eligible trading company" test.

60. Specifically, he went on to submit there was ample evidence to show that for as long as IR had any intention of starting a trade, its intended trade was as a mortgage lender in its own right. Its annual accounts right up to December 2004 stated that its principal activity "will be to act as a provider of residential mortgages". Once it had been realised that this was no longer possible, he submitted, the evidence showed that IR gave up all hope of trading and simply began to wind itself up, realising its assets as best it could. In his submission, this change took place in June 2005 once the proposed deal with UBS had collapsed (in November 2004) and it became clear that it was not possible to resurrect that deal (or a similar one with a new investor). He pointed to the facts (amongst others) that all the staff had been made redundant in December 2004 and in its accounts for the year to 31 December 2004 (which were signed on 31 March 2005) the auditors KPMG Audit plc referred to:

> "… the fundamental uncertainty as to the ability of the company to raise sufficient funding to enable it to launch its product and the uncertainty over the success of that launch and, therefore, over the company's continuing to operate."

Discussion and decision

61. It is hard to resist commenting that the legislation which is the subject of this appeal displays the sort of unnecessary drafting complexity that gives tax law a bad name. Film buffs will be reminded of Chico Marx's hot tip in the Marx Brothers' film "A Day at the Races".

62. First, the parties agreed (and we concur) that IR never reached the stage of actually carrying on a trade of any type. It seems equally uncontroversial (and indeed we have found – see [34(6)] above) that IR existed for the *purpose* of carrying on a trade, for at least part of its period of existence.

63. From our summary of the law at [52] above, it can be seen that in this case the pivotal question is whether, *throughout the relevant period*, IR existed "wholly for the purpose of carrying on one or more qualifying trades", or so existed "apart from purposes having no significant effect (other than in relation to incidental matters) on the extent" of its activities (see subsection 293(2) ICTA).

64. In a situation where IR's purposes changed over time, it is important to identify correctly what is the "relevant period" for these purposes. As stated at [54] above, Mr Maas submitted that it was the period that ended on 5 April 2006 and began, in relation to each tranche of the appellant's shares, twelve months before he subscribed for that tranche; he cited subsection 576(5) ICTA as authority for this. Mr Helm did not specifically address the meaning of the phrase "relevant period", though he implicitly accepted it could be much shorter than the period contended for by Mr Maas.

65. We do not agree with Mr Maas. Whilst we accept that the definition of "relevant period" contained in subsection 576(5) ICTA refers effectively to the period he identifies, that definition is specifically stated (by the introductory words to subsection 576(5)) to apply only "in sections 573 to 575 and this section"; the use of the phrase "relevant period" with which we are concerned, however, appears in section 293 ICTA (and, though less directly pertinent, in section 297 ICTA). Subsection 576(4A)(d) ICTA states quite clearly that when considering sections 293 and 297 ICTA for the purposes of the "eligible trading company" test in section 576 ICTA, references to "relevant period" in those sections have a special meaning, that is to say the time relevant to the "point in time" test in subsection 576(4)(a) ICTA or, "as the case may require", the period relevant to the "period of time" test in subsection 576(4)(b) ICTA. We consider this overrides the definitions that would otherwise apply when considering sections 293 and 297 for other purposes.

66. This makes sense in the overall scheme of the provisions (as far as it can be discerned). Subsection 576(4) ICTA is concerned with the status of the investee company at a particular point in time and in the period leading up to it; there would be no logical reason to take account of the company's status at some other (potentially far earlier) time when assessing that status. It is somewhat unfortunate that on its face the drafting requires a determination of the company's purpose both "throughout" a particular period of time and "throughout" a particular point in time – the latter being an obvious linguistic nonsense; but there is no other way to read the provisions and the only practical approach is to interpret the latter provision as requiring a determination of the company's purpose "at" the particular point in time, rather than "throughout" it.

67. In the present case, we have found that until around the end of July 2005, IR existed wholly or mainly for the purpose of carrying on a trade as a mortgage lender in its own right (see [34] above). Such a trade would, we find (and the parties agreed), fall foul of subsection 297(2)(c) ICTA. Therefore, it cannot have been a "qualifying company" (nor, therefore, an "eligible trading company") up to that time. But if there was *any time* from around the end of July 2005 up to 5 April 2006 when it could be said that IR existed wholly for the purpose of carrying on a qualifying trade

(or so existed "apart from purposes capable of having no significant effect (other than in relation to incidental matters) on the extent of the company's activities"), then:

> (1) if it so existed on 5 April 2006, it would satisfy the "point in time" test in subsection 576(4)(a)(i) and would, as long as its intention had persisted for some "continuous period", also satisfy the "period of time" test in subsection 576(4)(b)(ii); and
>
> (2) if it did *not* so exist on 5 April 2006, it would still satisfy the "point in time" test in subsection 576(4)(a)(ii) (by virtue of having ceased to exist for the relevant purpose during the previous three years) and would, as long as its intention had persisted for some continuous period up to the time of its cessation, also satisfy the "period of time" test in subsection 576(4)(b)(ii).

68. In either case, the consequence would be that IR, having been an "eligible trading company" both at a relevant point in time and over a relevant continuous period, would be a "qualifying trading company" within subsection 576(4) ICTA, thus entitling the appellant to his relief under subsection 574(1) ICTA.

69. So the question that arises is this: Has the appellant satisfied us, on a balance of probabilities, that there was a continuous period, starting after the abandonment of its plans to act as a mortgage lender in its own right, during which it could properly be said that IR was a company which:

> "[existed] **wholly** *(emphasis added)* for the purpose of carrying on one or more qualifying trades or which so [existed] apart from purposes capable of having no significant effect (other than in relation to incidental matters) on the extent of the company's activities"?

70. The burden lies on the appellant to show that this question should be answered in the affirmative. Clearly in answering it we are not concerned with IR's earlier activities and intentions, except insofar as they may cast light on its later purposes. The difficulty which the appellant faces is that the evidence of IR's intentions over the period in question is sketchy. Having considered that evidence with great care, we are not satisfied it shows that IR ever formed the necessary intention. Following the apparent abandonment of its purpose of becoming a mortgage lender in its own right around the end of July 2005, we do not feel able to infer from the evidence any clear purpose of IR to carry on any trade at all. The picture that emerges from the evidence is of a company with no clear purpose at all after July 2005, beyond making whatever financial recovery was possible for the shareholders following the failure of its former plan to become a mortgage lender, by whatever means that could be engineered (see [30] and [34(3)] above). Whilst some kind of qualifying trade was, or may have been, a possible outcome, it was just that – only one of a number of possible outcomes. We do not regard this as sufficient to satisfy the above test.

Summary

71. IR was not an eligible trading company at any time up to around the end of July 2005 because of its trading intentions to be a mortgage lender (see [67]).

72. From that time up to 5 April 2006, there was no point at which it could properly be said that IR was a company which existed wholly for the purpose of carrying on one or more qualifying trades or which so existed apart from purposes capable of having no significant effect (other than in relation to incidental matters) on the extent of its activities (see [70]).

73. Accordingly, IR was not at any time an "eligible trading company" and could not therefore be a "qualifying trading company" within the meaning of section 574 ICTA.

74. It follows that the appeal must be dismissed.

75. 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.

KEVIN POOLE
TRIBUNAL JUDGE

RELEASE DATE: 16 December 2014

Appendix

Relevant extracts from legislation (as in force in 2005-06, as applying to the shares the subject of this appeal)

Section 574 ICTA

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 paragraph (b) above.

…

Section 575 ICTA

575 – Exclusion of relief under section 573 or 574 in certain cases

(1) Sections 573 and 574 do not apply unless the disposal is –

…

(c) a deemed disposal under section 24(2) of the 1992 Act (claim that value of asset has become negligible).

…

Section 576 ICTA

576 – Provisions supplementary to sections 573 to 575

…

(3) There shall be made all such adjustments of corporation tax on chargeable gains or capital gains tax, whether by way of assessment or by way of discharge or repayment of tax, as may be required in consequence of relief being given under section 573 or 574 in respect of an allowable loss or in consequence of the whole or part of such a loss in respect of which a claim is made not being relieved under that section.

(4) For the purposes of sections 573 to 575 and this section a qualifying trading company is a company which –

(a) either –

(i) is an eligible trading company on the date of the disposal; or

(ii) has ceased to be an eligible trading company at a time which is not more than three years before that date and has not since that time been an excluded company, an investment company or a trading company that is not an eligible trading company; and

(b) either –

(i) has been an eligible trading company for a continuous period of six years ending on that date or at that time; or

(ii) has been an eligible trading company for a shorter continuous period ending on that date or at that time and has not before the beginning of that period been an excluded company, an investment company or a trading company that is not an eligible trading company; and

(c) has carried on its business wholly or mainly in the United Kingdom throughout the relevant period.

(4A) A company is an eligible trading company for the purposes of subsection (4) above at any time when, or in any period throughout which, it would comply with the requirements of section 293 if –

(a) the provisions mentioned in subsection (4B) below were omitted;

(ab) the reference in subsection (1A) of section 293 to the beginning of the relevant period were a reference to the time at which the shares in respect of which relief is claimed under section 573 or 574 were issued;

(b) the references in subsection (6) of section 293 to dissolution were omitted and after paragraph (a) of that subsection there were inserted –

"and

(b) the company continues, during the winding up, to be a trading company within the meaning of section 576(5)."

(c) the reference in section 293(6A) to the eligible shares were a reference to the shares in respect of which relief is claimed under section 573 or 574;

(d) any reference in section 293 (except subsection (1A)), 297 or 308 to the relevant period were a reference to the time that is relevant for the purposes of

subsection (4)(a) above or, as the case may require, the continuous period that is relevant for the purposes of subsection (4)(b) above;

(e) the reference in section 304A(1)(e)(i) to eligible shares were a reference to shares in respect of which relief is claimed under section 573 or 574;

(f) references in section 304A(3) to an individual were references to a person;

(g) the reference in section 304A(4) to section 304 were a reference to section 574(3)(b); and

(h) the reference in section 304A(6) to the expression "eligible shares" and "subscriber shares" were a reference to the expression "subscriber shares".

(4B) The provisions are –

(a) in section 293, the words 'Subject to section 294,' in subsection (1);

(b) sections 294 to 296;

(c) in section 298(5), the words 'and section 312(1A)(b) shall apply to determine the relevant period for the purposes of that section';

(d) in section 304A, subsections (1)(e)(ii) and (2)(b), in subsection (3), the words 'to which relief becomes so attributable' and paragraphs (c) and (d), in subsection (4), the words 'to which relief becomes so attributable' and paragraphs (c) and (d), and subsection (5); and

(e) section 308(5A).

(5) In sections 573 to 575 and this section –

…

"excluded company" means a company –

(a) which has a trade which consists wholly or mainly of dealing in land, in commodities or futures or in shares, securities or other financial instruments, or is not carried on on a commercial basis and in such a way that profits in the trade can reasonably be expected to be realised; or

(b) which is the holding company of a group other than a trading group; or

(c) which is a building society or a registered or industrial and provident society as defined in section 486(12);

…

"investment company" has the meaning given by section 130 except that it does not include the holding company of a trading group[1];

…

"relevant period" means the period ending with the date on which the shares in question are disposed of and beginning with the incorporation of the company or, if later, one year before the date on which the shares were issued;

…

"trading company" means a company other than an excluded company which is –

(a) a company whose business consists wholly or mainly of the carrying on of a trade or trades; or

(b) the holding company of a trading group;

"trading group" means a group the business of whose members, taken together, consists wholly or mainly in the carrying on of a trade or trades, but for the purposes of this definition any trade carried on by a subsidiary which is an excluded company shall be treated as not constituting a trade.

Section 293 ICTA

293 – Qualifying companies.

(1) Subject to section 294, a company is a qualifying company (whether it is resident in the United Kingdom or elsewhere) if it complies with the requirements of this section.

(1A) At *the beginning of the relevant period*[2] the company must be –

(a) an unquoted company, and

(b) a company to which subsection (1B) below does not apply.

(1B) This subsection applies to a company –

---

[1] Section 130 ICTA provides that '"investment company", means any company whose business consists wholly or mainly in the making of investments and the principal part of whose income is derived therefrom, but includes any savings bank or other bank for savings except any which, for the purposes of the Trustee Savings Bank Act 1985 is a successor or a further successor to a trustee savings bank.' IR clearly falls outside this definition.

[2] By virtue of section 576(4A)(ab) (see above), the italicized words are to be replaced by a reference to the time at which the shares in respect of which relief is claimed under section 573 or 574 were issued. In the present case, this means various dates from 8 October 2002 to 7 August 2004 – see [10]

(a) if arrangements are in existence for it to cease to be an unquoted company; or

(b) if –

(i) arrangements are in existence for it to become a subsidiary of another company ("the new company") by virtue of an exchange of shares, or shares and securities, in relation to which section 304A (certain exchanges resulting in acquisition of share capital by new company) applies, and

(ii) arrangements have been made with a view to the new company ceasing to be an unquoted company.

(2) The company must, throughout *the relevant period*[3], be –

(a) a company which exists wholly for the purpose of carrying on one or more qualifying trades or which so exists apart from purposes capable of having no significant effect (other than in relation to incidental matters) on the extent of the company's activities, or

(b) the parent company of a trading group.

…

(8A) Section 312(1A)(b) applies to determine the relevant period for the purposes of this section and sections 294, 295 and 296.[4]

Section 297 ICTA

297 – Qualifying trades

(1) A trade is a qualifying trade if it complies with the requirements of this section.

(2) Subject to subsection (9) below, the trade must not at any time in the relevant period consist of one or more of the following activities if that activity amounts, or those activities when taken together amount, to a substantial part of the trade –

…

(c) banking, insurance, money-lending, debt factoring, hire-purchase financing or other financial activities;

…

[3] By virtue of section 576(4A)(d) (see above), the italicized words refer to "the time that is relevant for the purposes of subsection (4)(a) above or, as the case may require, the continuous period that is relevant for the purposes of subsection (4)(b) above" – see [65]

[4] We consider that this provision is overridden by section 576(4A)(d) (see above) – see [65]

(e) leasing (including letting ships on charter or other assets on hire) or receiving royalties or licence fees;

…

(g) providing services or facilities for any trade carried on by another person (other than a company of which the company providing the services or facilities is the subsidiary) which consists to any substantial extent of activities within any of paragraphs (a) to (fe) above and in which a controlling interest is held by a person who also has a controlling interest in the trade carried on by the company.

…

(4) A trade shall not be treated as failing to comply with this section by reason only that at some time in the relevant period it consists to a substantial extent in the receiving of royalties or licence fees if the royalties and licence fees (or all but for a part that is not a substantial part in terms of value) are attributable to the exploitation of relevant intangible assets.

(5) For this purpose an intangible asset is a "relevant intangible asset" if the whole or greater part (in terms of value) of it has been created –

(a) by the company carrying on the trade…

…

(5A) For the purposes of subsection (5) above –

(a) in the case of an intangible asset that is intellectual property, references to the creation of the asset by the company are to its creation in circumstances in which the right to exploit it vests in the company (whether alone or jointly with others);

…

(5B) For the purposes of subsections (4) to (5A) above "intangible asset" means any asset which falls to be treated as an intangible asset in accordance with generally accepted accounting practice.

(5C) In subsection (5A)(a) above "intellectual property" means –

(a) any patent, trade mark, registered design, copyright, design right, performer's right or plant breeder's right; and

(b) any rights under the law of a country or territory outside the United Kingdom which correspond or are similar to those falling within paragraph (a) above.

…

(8) The trade must, during *the relevant period*[5], be conducted on a commercial basis and with a view to the realisation of profits.

Section 298 ICTA

298 – Provisions supplementary to sections 293 and 297

…

(3) References in this section and section 297 to a trade shall be construed without regard to so much of the definition of "trade" in section 832(1) as relates to adventures or concerns in the nature of trade; but the foregoing provisions do not affect the construction of references in section 297(2)(g) or subsection (1) above to a trade carried on by a person other than the company and those references shall be construed as including a reference to any business, profession or vocation.

…

(5) In section 297 –

…

and section 312(1A)(b) shall apply to determine the relevant period for the purposes of that section.[6]

Section 312 ICTA

312 – Interpretation of Chapter III

(1) In this Chapter –

"termination date" in relation to any eligible shares issued by a company means the third anniversary of the issue date or if –

(a) the money raised by the issue was raised wholly or mainly for the purpose of a qualifying business activity falling within section 289(2)(a) (company meeting trading activities requirement by reason of the company or a qualifying 90% subsidiary of the company carrying on or preparing to carry on a qualifying trade), and

(b) neither the company nor any of its qualifying 90% subsidiaries had begun to carry on the qualifying trade on the issue date,

---

[5] By virtue of section 576(4A)(d) (see above), the italicized words refer to "the time that is relevant for the purposes of subsection (4)(a) above or, as the case may require, the continuous period that is relevant for the purposes of subsection (4)(b) above"

[6] We consider that this provision is overridden by section 576(4A)(d) (see above) – see [65]

the third anniversary of the date on which the company or any qualifying 90% subsidiary of the company begins to carry on that trade;

…

(1A) In any provision of this Chapter "relevant period", in relation to any eligible shares issued by a company, means whichever of the following periods is applied for the purposes of that provision –

(a) the period beginning either –

(i) with the incorporation of the company, or

(ii) if the company was incorporated more than two years before the date on which the shares were issued, two years before that date,

and ending immediately before the termination date relating to the shares, and

(b) the period beginning with the issue of the shares and ending immediately before the termination date relating to them.