TC5044

Appeal number: TC/2015/04076
TC/2015/04077
TC/2015/04078

INCOME TAX – share loss relief – whether shares were ordinary shares – no – appeals dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

COLIN BIELCKUS **Appellants**
MARK ARNELL
KEVIN TAYLOR

- and -

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

TRIBUNAL: JUDGE ANNE REDSTON
MRS CLAIRE HOWELL

Sitting in public at Fox Court, Brook Street, London on 30 March 2016

Mr Colin Bielckus in person and as the representative of the other two Appellants

Mr Simon Bates of HM Revenue and Customs' Appeals and Reviews Unit, for the Respondents

DECISION

1. Mr Bielckus, Mr Arnell and Mr Taylor ("the Appellants") claimed share loss relief in their 2010-11 self-assessment ("SA") tax returns in relation to shares they had held in a company called Davis World Travel Limited ("DWTL").

2. HM Revenue and Customs ("HMRC") amended the Appellants' returns by removing the claimed loss in relation to certain of those shares ("the Shares") on the basis that they were not "ordinary shares" within the meaning of the relevant legislation. The Appellants appealed.

3. Having considered the evidence and the parties' submissions, the Tribunal found that the Shares were not ordinary shares. It follows that HMRC's amendments were rightly made and the Appellants' appeals are dismissed.

The Appellants

4. Mr Bielckus is one of the Appellants, but he is also a chartered accountant with his own accountancy practice, Avenue Business Services. In that capacity, he filed the 2010-11 SA returns for Mr Arnell and Mr Taylor, and was instructed to represent them in relation to the Tribunal proceedings.

5. On 14 July 2015, the Tribunal directed that the three appeals were to proceed together and be heard together by the same Tribunal.

6. The parties agreed that the facts and issues of all three appeals were the same, other than that:

(1) Mr Bielckus held more Shares than the other Appellants (see §13-14); and

(2) each Appellant claimed a different amount of share loss relief in relation to the Shares (see §20).

The evidence

7. HMRC provided a helpful bundle of documents which included:

(1) the correspondence between the parties and between the parties and the Tribunal;

(2) certain correspondence between DWTL and the Association of British Travel Agents ("ABTA");

(3) extracts from the Appellants' 2010-11 SA tax returns;

(4) the statutory accounts ("the Accounts") of DWTL for the three years ended 31 October 2007, 2008 and 2009, prepared by Mr Bielckus' firm; and

(5) certain documents from Companies House, being DWTL's return of allotments of shares dated 19 May 2008; its annual return of share capital dated 6 December 2009 (filed on 17 February 2010) and a summary of the information held by Companies House dated 10 November 2011.

8. Mr Bielckus gave oral evidence, was cross-examined by Mr Bates and answered questions from the Tribunal. We found him to be a generally honest and straightforward person, although his evidence on the key point in this appeal, namely the rights attaching to the Shares, was neither consistent nor reliable, as we explain below.

The facts not in dispute

9. From the evidence provided, we find the following facts, none of which is in dispute.

10. In the period before 1 November 2006, Mr Arnell and Mr Taylor worked in a travel agency called Davis World Travel ("DWT"). The senior partner of DWT decided to retire, but Mr Arnell, Mr Taylor and a third individual, Mr Dewey, wanted to continue in business. They decided to form a company together with Mr Bielckus, who had been DWT's accountant.

11. On 1 November 2006 Mr Bielckus acquired DWTL's two initial subscriber shares. DWT's business was subsequently transferred into DWTL and the company began trading.

12. On 17 November 2006, Mr Bielckus was allotted 12,498 ordinary £1 shares in DWTL at par; the other Appellants and Mr Dewey were each allotted 12,500 ordinary £1 shares at par. The equity was therefore split equally between the shareholders.

13. On 28 June 2007, each shareholder was allotted 55,000 shares at a par value of £1, making a total of 220,000 shares. These are the Shares at issue in these proceedings. They are described in each set of Accounts as "cumulative redeemable preference shares of £1 each."

14. On 19 May 2008, Mr Bielckus was allotted a further 85,048 Shares in exchange for cash consideration of £85,048. Their terms of issue were that they ranked *pari passu* with the existing Shares, and they are included with those Shares in the 2008 and 2009 Accounts.

15. For the purposes of this decision we have used the term "Shares" to include both the original allotments of 55,000 on 28 June 2007 and the further allotment of 85,048 on 19 May 2008. We make further findings of fact about the Shares later in our decision.

16. DWTL's turnover in the year ended 31 October 2007 was £703,202, being commissions receivable on sales of around £8-9m. After other operating income, interest payable and administrative expenses, DWTL made a loss of £29,038 in that year.

17. In 2008 DWTL's turnover was similar, at around £665,471, and it made a loss of £48,029. The Tribunal was not provided with a turnover figure for 2009, as the Accounts for that year were abbreviated form, but we infer from DWTL's balance sheet that the company made a loss of £153,521.

18. In April 2010, the travel industry was seriously affected by the Icelandic volcano. That disruption caused further stress to DWTL's financial position, and it became insolvent. On 5 January 2011 a liquidator was appointed and on 8 June 2012 DWTL was struck off.

19. The Appellants and Mr Dewey submitted SA returns for the 2010-11 tax year. They each claimed share loss relief on both the ordinary shares and the Shares, and made claims to carry back part of the loss on the Shares to the previous tax year.

20. On 4 January 2013 Mrs Pagano of HMRC opened enquiries into the Appellants' returns. She subsequently issued closure notices and amended the returns to remove the share loss relief claims relating to the Shares. As a result of those amendments, the further tax due from the Appellants was as follows:

Shareholder	2009/10	2010/11
Mr Bielckus	£10,366.15	£1,602.50
Mr Arnell	£4,326.50	£2,012.80
Mr Taylor	£5,210.30	£4,765.40

21. The Appellants and Mr Dewey asked for a statutory review, but the HMRC Review Officer upheld Mrs Pagano's decisions. The Appellants (but not Mr Dewey) appealed to the Tribunal.

The law

22. There was no dispute as to the relevant law, which is as follows.

23. Chapter 6 of the Income Tax Act 2007 ("ITA") is headed "Losses on disposal of shares." Within that Chapter, s 131 provides that:

> "(1) An individual is eligible for relief under this Chapter ('share loss relief') if:
>
> (a) the individual incurs an allowable loss for capital gains tax purposes on the disposal of any shares in any tax year ('the year of the loss'), and
>
> (b) the shares are qualifying shares…
>
> (2) Shares are qualifying shares for the purposes of this Chapter if:
>
> (a) EIS relief is attributable to them, or
>
> (b) if EIS relief is not attributable to them, they are shares in a qualifying trading company which have been subscribed for by the individual."

24. ITA s 151(1) can be found towards the end of Chapter 6, and is headed "interpretation of Chapter." So far as relevant to this decision, it reads:

> "In this Chapter…

> ‘shares’
>
> (a) includes stock, but
>
> (b) does not include shares or stock not forming part of a company's ordinary share capital.”

25. Part 16 of ITA is entitled “Income Tax Definitions etc” and Chapter 1 of that Part is headed “Definitions.” ITA s 988 sits within that Chapter, and begins:

> “(1) This Chapter contains definitions which apply for the purposes of the Income Tax Acts, except where, in those Acts, the context otherwise requires.”

26. The ITA is an “Income Tax Act” and the Appellants did not seek to argue that the context here required any different definition from that in Chapter 1 of Part 16.

27. ITA s 989 is also within Chapter 1 of Part 16 and it is headed “the definitions.” It opens by saying “The following definitions apply for the purposes of the Income Tax Acts…” A long list of definitions then follows, including this one:

> “‘ordinary share capital’, in relation to a company, means all the company’s issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company’s profits.”

The issue

28. The parties explicitly confirmed to the Tribunal that the only issue in dispute was whether the Shares were ordinary shares for the purposes of the share loss relief provisions.

29. In particular, there was agreement that no EIS relief was attributable to the Shares. There was also no dispute about the quantum of the amendments, namely the sums which would be due if the appeals were to fail; about the capital losses claimed; about whether DWTL was a qualifying trading company; and/or as to whether the Appellants had subscribed for the ordinary shares and the Shares.

The Shares

Further findings of fact from the documentary evidence provided

30. On 23 May 2007, DWTL applied to join ABTA. On 27 June 2007 ABTA wrote to DWTL, saying that its financial documents showed the company to have insufficient capital for ABTA membership, but that:

> “this could be corrected by capitalising sufficient of the directors’ loans. Redeemable preference shares would be sufficient for our purposes.”

31. Mr Bielckus replied (by an undated email) saying “we will capitalise sufficient of the directors’ loans as redeemable preference shares as is necessary to leave £50,000 of net assets excluding goodwill.”

32. On 28 June 2007, ABTA wrote to DWTL saying that they required evidence of the allotment of the new shares and that:

> "if not ordinary shares, the full terms attaching to them should be advised to us, and if the terms include a right of redemption the company must enter into our standard form of undertaking to give notice of any proposed redemption and not to effect any such redemption without having received the Association's prior written consent."

33. On 2 July 2007 Mr Bielckus replied. In relation to the Shares, he said:

> "1. We enclose a copy of Form 123 submitted to Companies House on 28 June for your information, and
>
> 2. The terms of the shares are as follows. They are 7.5% cumulative redeemable preference shares and the completed standard form of undertaking is enclosed. With your consent, it is our intention to redeem them in line with the attached spreadsheet but only if there are profits to do so. The first redemption would be at 31 October 2008."

34. Form 123 was not provided to the Tribunal, but the Annual Return dated 6 December 2009 says "all ordinary shares rank *pari passu* for all purposes" and that "preference shares acquire voting rights *pari passu* to ordinary shares in the event of arrears of dividends." The same words are used on the summary of the information held by Companies House on 10 November 2011, after DWTL had gone into liquidation.

35. The Notes to the Accounts for all three years included the following paragraph:

> "Preference shares are cumulative and redeemable. They attract a fixed right to dividends of 7.5% per annum. The shares are redeemable in annual instalments at par in an inverse sum-of-the-digits basis but only with the prior written consent of ABTA. They rank in priority of [sic] the ordinary shares only and can vote *pari passu* with the ordinary shares in the event of arrears of the cumulative dividend."

36. The Accounts for the year ended 31 October 2007 show that dividends of £5,500 were owed on the Shares at the end of that first accounting period. This is the total of all the dividends to which the shareholders were entitled since issuance of the Shares (£220,000 x 7.5% x 4 months). We find that no preference dividend was paid on the Shares in that year.

37. The subsequent Accounts show that the dividend arrears had increased to £24,326 by October 2008 and to £51,067 by October 2009. In both years, the arrears were for the total dividend due on the Shares since issuance. We therefore find that no dividend was ever paid on the Shares.

Mr Bielckus' oral evidence

38. Mr Bielckus said that when he "wrote the rights of the Shares the intention was that they became the same as ordinary shares if the dividends were in arrears" and that they would therefore have "all the rights of an ordinary share."

39. He told the Tribunal that this intention was recorded in the notes of the directors' meeting when the Shares were issued, but that he had been unable to locate a copy of those notes. He added that "one of problems with the liquidation is that various bits of paper vanished."

40. When the Tribunal asked Mr Bielckus what would happen to the Shares if DWTL subsequently became profitable, he said that the company had "not got round to solving that."

41. However, when Mr Bates later asked him why the shareholders had not subscribed for ordinary shares, he said:

> "If you have ever tried to remove or redeem an ordinary share you will understand why you don't have them in a situation like this. Had they been issued as ordinary shares and we wanted to take them back again – the hoops we had to go through to get the money back would be substantially more difficult, so we went with the ABTA suggestion."

42. Mr Bates also asked Mr Bielckus whether he had researched the differences between ordinary and preference shares. Mr Bielckus replied:

> "That is why the special provisions were made on the shares. In other words we were trying to get the best of both worlds. These were shares that would act as ordinary shares if dividends were in arrears but once we had weathered the storm and got back to a profitable position ABTA would have allowed us to move the money back out again."

The submissions

Mr Bielckus' submissions on behalf of the Appellants

43. Mr Bielckus said that there was a preliminary question as to whether (a) shares qualified for share loss relief if they were "ordinary shares" at the date they became of negligible value, or (b) the shares only qualified for share loss relief if they were ordinary shares at the time they were issued to the shareholders.

44. In his submission, option (a) was correct, and that was the position here. Although the Shares were called "redeemable preference shares" it was necessary to look at the reality. When the Shares became of negligible value the dividends were in arrears, and so the Shares took all the attributes of and ranked *pari passu* with the DWTL's ordinary shares.

45. This had been the company's intention throughout, although Mr Bielckus accepted that the Notes to the Accounts did not fully reflect that intention. The Appellants' grounds of appeal to the Tribunal state that "the directors will be willing to give any undertakings HMRC might wish that this was the case."

46. Mr Bielckus said that if he was wrong in this, so that option (b) was correct, namely that shares only satisfied the statutory test if they were ordinary shares on the issue date, he submitted that:

(1) as DWTL had never made payment of dividends on any of the Shares, they were "the equivalent of ordinary shares from date of issue"; and

(2) this was particularly evident in relation to the further 85,048 Shares which were issued to him on 19 May 2008, as by then there was already a build-up of arrears on the Shares.

Mr Bates' submissions on behalf of HMRC

47. Mr Bates said that the legislation was clear and unambiguous and could be summarised as follows:

(1) share loss relief only applies to "shares" (ITA s 131);

(2) the term "shares" is defined to exclude "shares…not forming part of a company's ordinary share capital" (ITA s 151(1);

(3) the term "ordinary share capital" is in turn defined as "all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits" (ITA s 989).

48. On the facts of this case, the Shares carried the right to a dividend at a fixed rate, but had no other right to share in the company's profits. Mr Bates accepted that, as the dividends were in arrears, the Shares had acquired voting rights *pari passu* to the ordinary shares, but said that "there is no evidence to indicate that the [Shares] also ranked *pari passu* for other purposes including a right to share in the company's profits."

49. Mr Bates referred to the recent decision of the First-tier Tribunal ("FTT") in *Castledine v HMRC* [2016] UKFTT 0145(TC) ("*Castledine*") (Judge Cornwell-Kelly and Mr Menzies-Conacher). In *Castledine* the appellants had submitted that certain deferred shares were not "ordinary shares" for the purposes of entrepreneurs' relief. The definition at issue was that in ITA s 989, the same provision as was relevant to the Appellants' appeals.

50. Mr Bates said that Mr Hall, who represented HMRC in *Castledine*, had traced the origin of that definition to Finance Act 1938, s 42(3), see [32] of the decision. In their judgment, the FTT had said that:

> "[44] …the definition at issue in section 989 of the 2007 Act can hardly be said to be characterised by an 'error', which has lain undiscovered since 1938 – its long and unchallenged existence suggests indeed the contrary…
>
> [45] It would appear that parliament is here making it clear that there are to be no fine distinctions or special exceptions in the matter; that a simple, broad brush, easily workable, approach is mandated…"

51. Although the issue in *Castledine* concerned the first part of the definition in ITA s 989, and the Appellants' appeals related to the second part of that definition, Mr Bates invited the Tribunal to take a similar approach, and find that the legislation was

straightforward and unambiguous. When it was applied to the facts of this case, it was, he said, clear that the Shares failed to qualify for share loss relief.

Discussion

52. ITA s 989 states that share capital "the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits" is not ordinary share capital.

53. The Shares carried "a right to a dividend at a fixed rate," being 7.5% per annum. This is not in dispute. The question is whether, once these fixed rate dividends were in arrears, the special terms attached to the Shares gave them any right to share in the company's profits in addition to that fixed rate dividend.

54. There are three sources of documentary evidence before the Tribunal:

(1) The Notes to the Accounts, which for each of the three years expressly state that the Shares had "the right to vote *pari passu* with the ordinary shares in the event of arrears of the cumulative dividend";

(2) Mr Bielckus' letter to ABTA of 2 July 2007, which begins "the terms of the shares are as follows…";

(3) The information held at Companies House, which says that "all ordinary shares rank *pari passu* for all purposes" and that "preference shares acquire voting rights *pari passu* to ordinary shares in the event of arrears of dividends."

55. When assessing that evidence, we note that:

(1) The Companies House information is an official record of the rights attaching to the Shares. The Annual Return dated 6 December 2009 and the summary of information dated 10 November 2011 both say that the "preference shares acquire voting rights *pari passu* to ordinary shares in the event of arrears of dividends." There is no mention of any different or wider rights.

(2) the letter of 2 July 2007 to ABTA is contemporaneous with the issue of the Shares;

(3) that letter is a response to the ABTA requirement, set out in their letter of 28 June 2007, that (our emphasis) "if not ordinary shares, the full terms attaching to them should be advised to us." If the Shares had the right to rank *pari passu* in all respects with the ordinary shares, it is surprising that this was not mentioned by Mr Bielckus when he replied.

(4) Although his letter was accompanied by Form 123, and that Form was not provided to us, we infer from the Companies House information which was in the Bundle that Form 123 also made no reference to any such further rights;

(5) the Note to the Accounts is particularised rather than general: it says "The shares are redeemable in annual instalments at par in an inverse sum-of-the-digits basis but only with the prior written consent of ABTA." Again, if the Shares had other rights, it is surprising that they were not mentioned in this detailed Note;

(6) the Note is repeated in the same terms for three years, so this was not a one-off error or omission;

(7) Mr Bielckus' firm prepared the Accounts, so he would have had every opportunity to have detailed oversight of the content of the Notes; and

(8) no dividends were ever paid on the Shares, so the condition for the extra right to be exercised existed at least from 31 October 2007. It is reasonable to think this might have caused the company to review and amend the Note, if it was in fact incorrect.

56. The documentary evidence therefore comes from a variety of sources and covers the whole of the relevant period, from issuance of the Shares to the company's liquidation. It consistently states that, when the dividends are in arrears, holders of the Shares have the right to vote with ordinary shareholders at general meetings, until the arrears are paid. None of the documentary evidence states that the holders of the Shares have any entitlement to the company's profits in addition to their fixed rate dividends.

57. On the basis of that strong evidence, the positon is crystal clear: the Shares are not ordinary shares.

58. However, Mr Bielckus said that the company intended to give the Shares "all the attributes of…the company's ordinary shares"; that this had been recorded in a directors' minute at the time the Shares were issued; although that document could not now be located, "the directors will be willing to give any undertakings HMRC might wish that this was the case."

59. We do not accept this evidence. The Shares were issued because of ABTA's requirement that the company strengthened its balance sheet. DWTL were given a choice between ordinary shares and redeemable shares. It chose the latter because, as Mr Bielckus said in oral evidence "had they been issued as ordinary shares and we wanted to take them back again – the hoops we had to go through to get the money back would be substantially more difficult." He also said "once we had weathered the storm and got back to a profitable position ABTA would have allowed us to move the money back out again." Furthermore, on 2 July 2007, Mr Bielckus told ABTA that "it is our intention to redeem [the Shares] in line with the attached spreadsheet but only if there are profits to do so. The first redemption would be at 31 October 2008."

60. It follows that we also do not accept Mr Bielckus' statement that the company had "not got round to solving" the question of what would have happened when the company became profitable. That is contradicted by his other evidence, as set out in the previous paragraph, as well as by the letter to ABTA. We find that if the company had become profitable, the Shares would have been redeemed.

61. To the extent that Mr Bielckus is submitting that DWTL's intention was relevant to the status of the Shares, and that the company intended that the Shares carry all the rights of ordinary shares, even though this did not in fact happen, we find, first, that the rights attaching to shares is a matter of fact and law which cannot be changed by an intention which was never implemented. Second, on the basis of

the evidence in the preceding paragraphs, we find that it always the company's intention that the Shares remain fixed preference shares with the limited rights set out in the Accounts.

62. In reliance on the documentary evidence before the Tribunal, we therefore conclude that the Shares never had "all the attributes of…the company's ordinary shares" but rather remained redeemable preference shares with no right to share in the company's profits other than in relation to the fixed dividend. They were therefore not "ordinary share capital" within the meaning of ITA s 989.

63. Mr Bates did not address us on the question of whether the statutory test needed to be satisfied (a) on the date of issue, or (b) on the date when shares became of negligible value, because the Shares had never been ordinary shares.

64. We agree, and find that there is no need for the Tribunal to explore and decide that point. We merely observe that Mr Bielckus' submissions in relation to some or all of the Shares being treated *pari passu* with the ordinary shares from the issue date on the basis that there were outstanding dividend arrears on that date is incorrect. Arrears can only arise on shares after the company has failed to pay a dividend on the agreed payment date, and that date must of necessity post-date their issue.

65. Like the Tribunal in *Castledine,* we find that ITA s 989 provides "a simple, broad brush, easily workable, approach" to the dividing line between ordinary shares and other shares. The Shares are clearly not on the "ordinary shares" side of that line.

Decision and appeal rights

66. For the reasons set out above, we find that the Appellants have no entitlement to share loss relief in relation to the Shares. Their appeals are dismissed and HMRC's amendments to their 2009-10 tax returns upheld.

67. 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.

68. 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.

ANNE REDSTON
TRIBUNAL JUDGE

RELEASE DATE: 7 APRIL 2016