[2019] UKFTT 694 (TC)

TC07467

INCOME TAX - ENTERPRISE INVESTMENT SCHEME – tax relief - Prior Dividends – construction of legislation – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2017/00170

BETWEEN

FOOJIT LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE JENNIFER DEAN

Sitting in public at Manchester on 23 July 2019

Mr Richard Chapman QC, Counsel for the Appellant

Mr Simon Foxwell, litigator of HM Revenue and Customs' Solicitor's Office, for the Respondents

DECISION

INTRODUCTION

1. By Notice of Appeal dated 16 December 2016 the Appellant appealed against HMRC's refusal to authorise the issue of compliance certificates pursuant to the Enterprise Investment Scheme (hereafter "the EIS") for shares issued on 18 November 2014.

2. By way of background, the Appellant was incorporated on 22 January 2014 and carries on business in the provision of hybrid mail solution services to businesses.

3. In 2014 the Appellant wished to issue shares for a total subscription of £400,000 to investor shareholders ("the B Shares" and "the B Shareholders") in order to raise investment. The Appellant also wished to provide enhanced protection to the B Shares and B Shareholders as compared to the existing shares and shareholders ("the A Shares" and "the A Shareholders"). The Appellant also wished to ensure that the subscriptions to the B Shares would benefit would benefit from tax relief pursuant to the EIS; the tax relief on the £400,000 share issue would be £120,000.

4. HMRC offer a non-statutory service 'advance assurance' whereby a company can obtain HMRC's opinion of a proposed transaction in advance of issuing shares.

5. On 28 August 2014 the Appellant applied for advanced assurance in respect of the EIS. On 7 October 2014 HMRC confirmed that EIS authorisation would be provided if a satisfactory EIS 1 certificate was filed. This included certification that the shares complied with the requirements of the Income Tax Act 2007 ("ITA 2007").

6. For completeness I should note that the Appellant also applied for assurance in respect of the Seed Investment Scheme ("SEIS") which was not given by HMRC for reasons that are not relevant to this appeal. The refusal to provide assurance in respect of SEIS does not form part of this appeal.

7. On 18 November 2014 the Appellant amended its Articles of Association ("the Articles") in order to facilitate the share issue. 910 £1 B Shares were then issued for a subscription of £400,000.

8. The Appellant submitted form EIS 1 on 16 January 2015. HMRC refused to grant authorisation on 30 January 2015 on the basis that the B Shares carried an excluded preferential right within the defined statutory period. HMRC's decision was upheld on review on 16 November 2016.

ISSUES

9. There was no dispute between the parties as to the facts. The issues between the parties relate to the nature of the B Share's rights, whether or not the B shares are excluded under the EIS and whether HMRC was correct to refuse the authorisation of EIS compliance certificates for the share issue on 18 November 2014.

LEGAL FRAMEWORK

10. The relevant provisions of s173 ITA 2007 provide as follows:

> 173 (1) The relevant shares must meet—
>
> (a) the requirements of subsection (2),
>
> …

(2) Shares meet the requirements of this subsection if they are ordinary shares which do not, at any time during period B, carry—

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

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

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

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

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

…

AUTHORITIES

11. The parties cited a number of cases in support of their respective cases. The Appellant relied on *Flix Innovations Ltd v HMRC* [2016] UKUT 301 (TCC) ("Flix") and *Abingdon Health Ltd v HMRC* [2016] UKFTT 800 (TC), albeit with the acknowledgment that both focussed on there being any preferential right to the return of capital rather than any preferential right to dividends. The Appellant submitted that both cases make it clear that the EIS legislation is highly prescriptive and that the use of the word "any" preferential right means that a theoretical or small right should not be ignored. In *Flix* the UT stated at [43] and [44]:

> "We also accept that Part 5 ITA 2007 is, as the FTT found, "closely articulated" legislation. Again, as this Tribunal said in *Trigg* at [33], the fact that the relevant legislation is highly detailed, prescriptive or "closely articulated" does not exclude the general principle that the statutory words must receive a purposive construction. Nonetheless, it is true, as Lewison J indicated in *Berry*, that highly prescriptive or formulaic legislation will often give less scope for a purposive interpretation resulting in a meaning which is different from the literal meaning.
>
> In this case, the FTT concluded that, in the case of the "highly articulated" provisions of Part 5 ITA 2007, it was unlikely that Parliament would have intended to permit a small or insignificant preferential right to be ignored in applying section 173(2)(aa) without doing so expressly. We agree. In the context of the highly detailed provisions of Part 5 ITA 2007 and the use of the word "any" in section 173(2)(aa) it is impossible to ignore the preferential rights carried by the Ordinary Shares. To do so would, in Lord Hoffmann's words, be to rectify the language of the statute rather than to construe it purposively."

12. Mr Chapman noted that the Companies Acts do not provide any definition of "preferential shares". However, guidance can be found in *Shares and Share Capital under the Companies Act 2006* by Andrew McGee (at 3.5.2.2) and in *Bond v Barrow Haematite Steel Co* [1902] 1 Ch 353, Farwell J stated:

> "This article, in my opinion, provides that all new shares shall be subject in all respects to the provisions of the articles, except only that dividends payable on new shares may

rank in priority to instead of pari passu with ordinary shares. For this purpose it is necessary only to introduce modifying words into art. 95 for the whole fascicules of clauses relating to dividends - viz, 95 to 101 - to apply.

It is argued that the provisions as to declaration of dividend do not apply to shares on which a fixed preferential dividend is payable. I do not think so. The necessity for a declaration of a dividend is a condition precedent to an action to recover, as stated in general terms in LINDLEY ON COMPANIES (5th Edn) p. 437, and where the reserve fund article applies it is obvious that such a declaration is essential, for the shareholder has no right to any payment until the corporate body has determined that the money can properly be paid away. It is urged that this puts the preference shareholders at the mercy of the company. But they came in on these terms, and this argument does not carry much weight in an action such as this where bona fides is conceded. The opposite conclusion might enable preference shareholders to ruin the company, and would certainly lead to great inconvenience in enabling them to compel the payment out of the last penny without carrying forward any balance. Granted that it is a hardship to go without dividends for a time, this hardship presses more heavily on the ordinary shareholders, who have to wait till the preference shareholders receive all arrears before they can get anything. It was urged that art 97, providing for a reserve fund, could not apply to preference shares because one of its objects is to equalise dividends. But I cannot see that the mention of one object which is not applicable is any reason for excluding those objects which are applicable, and which are really for the benefit of all the shareholders.

On the articles as they stand I have no doubt that the true construction is that which I have stated."

13. Mr Chapman submitted, quoting Palmer's Company Law at 6.110 in support, that the position as set out above can be expressly or impliedly altered by the articles:

> "Preference shares almost always carry a preferential right to a fixed dividend. This is expressed as a percentage of the nominal value of the share. Thus, eg, there can be 6 per cent preference shares.
>
> But like all dividends this right only applies if there are distributable profits lawfully available to the company. The right is not to a dividend but to preferential treatment if and when one is distributed. That in turn depends upon the terms of the articles as to whether this right only arises when a dividend is declared. The articles may provide that provided there are distributable profits a preference dividend should be distributed. That will be up to the fixed amount of the dividend.
>
> Alternatively they may provide that the preference dividend shall be declared by the directors rather than by the general meeting. This gives the directors a discretion. In other cases the articles may provide that the preferential dividend is deemed to be due on certain dates."

14. Mr Chapman submitted that this depends on the proper construction of the Articles. In *Dashfield v Davidson* [2008] EWHC 486 (Ch), Lewison J summarised the approach to construction as follows (at [50]):

> "I turn to the construction of art 14. In construing art 14 one must beware of hindsight. It must be interpreted in a businesslike way, and ought to produce a workable result in a variety of possible factual scenarios. It would be wrong to interpret it in a way that was tailor-made for the particular facts of this case."

15. Mr Chapman submitted that the Tribunal's role is to ascertain the objective meaning of articles within the Articles of Association which, where there is ambiguity, can include an

analysis of business common sense. In *PM Law Ltd v Motorplus Ltd* [2018] EWCA Civ 1730 the Court stated (at [12]):

> "It is common ground that the court's task when construing clause 1 of the 2007 Agreement is to ascertain the objective meaning of the words used by the parties in the context of the 2007 Agreement as a whole, taking into account the relevant factual background which would have been available to the parties, but excluding subjective evidence of the parties' intentions. The court must focus on the meaning of the relevant words in their documentary, factual and commercial context. If there is an ambiguity, or in other words, there are rival meanings, the court can give weight to the implications of the rival constructions by reaching a view as to which is more consistent with business common sense: *Arnold v Britton & Ors* [2015] AC 1619 per Lord Neuberger PSC at [14] – [23] and *Wood v Capita Insurance Services Limited* [2017] AC 1173: [2017] UKSC 24 per Lord Hodge JSC at [8] – [15]."

THE ARTICLES IN DISPUTE

16. The relevant Articles as amended are as follows:

> 2. Dividends
>
> 2.1. The Company shall, in priority to the payment of any dividend to all other Members, pay the holders of the B Ordinary Shares a prior dividend equivalent to 44 per cent of the Profits available for distribution.
>
> 2.2. The Prior Dividend:
>
> 2.2.1. will be paid in cash;
>
> 2.2.2. is a fixed percentage which may not be altered by resolution of the board of directors or the members;
>
> 2.2.3. shall be distributed amongst the holders of the B Ordinary Shares pro rata according to the number of B Ordinary Shares held by each of them respectively;
>
> 2.2.4. is not cumulative; and
>
> 2.2.5. will cease to be paid or payable once each B Ordinary Shareholder has received an aggregate of £120,000 in Prior Dividends.
>
> 2.3. Subject to Prior Dividend having been paid the balance of any Profits which the Company, on the recommendation of the Directors, determines to distribute in respect of any Accounting Period will be applied, on a pro-rata basis, between the Shares.
>
> 3. Return of capital
>
> 3.1. On a return of capital, whether on liquidation, capital reduction or otherwise (but excluding a purchase of own shares made in accordance with the provisions of these Articles), any surplus assets of the Company remaining after the payment of its liabilities shall be applied to the Shares pro-rata as if they constituted one class of Shares.

SUBMISSIONS ON BEHALF OF THE APPELLANT

17. Mr Chapman submitted that Article 3.1 makes it clear that the B shares do not carry any present or future preferential right on the Appellant's rights on a winding up as the assets are to be applied pro-rata as if they constituted one class of shares. As such, the B Shares are not excluded by s 173(2)(aa) ITA 2007.

18. The Articles do not make any provision for the B Shares to carry any present or future right to be redeemed. As such, the B Shares are not excluded by S 173(2)(b) ITA 2007.

19. It is accepted that the B Shares do carry a preferential right to dividends, primarily because Article 2.1 refers to the dividends being payable in priority to the payment of any dividend to any other members and also because the amount of the dividend is 44% of the Profits available for distribution rather than being restricted to 44% of the amount of any dividends declared. Therefore, the B Shareholders are in a better position than the A Shareholders as they are not dependent upon the amount declared as a dividend.

20. However, s173(2)(a) ITA 2007 excludes shares which carry any present or future preferential right to dividends *that is within subsection (2A).* It is not enough that the B Shares are preferential for them to be excluded; the preferential right must be one whereby *the amount of any dividends payable pursuant to the right, or the date or dates on which they are payable, depend to any extent on a decision of the company, the holder of the share or any other person* (Appellant's emphasis).

21. The Appellant submits that neither the amount of dividends payable nor the dates upon which they are payable depend upon a decision of the company, the respective B Shareholder or any other person for the following reasons:

(1) Article 2.1 clearly states that the B Shares are equivalent to 44% of the Profits available for distribution;

(2) Article 2.2.2 states that the prior dividend "is a fixed percentage which may not be altered by resolution of the board of directors or the members".

22. Furthermore, Mr Chapman submitted, the dates on which the dividends are payable do not depend on a decision by the Appellant, the respective B Shareholder or any other person for the following reasons:

(1) The Articles are to be construed as making the prior dividend payable upon the signing off of the audited consolidated profit and loss account in respect of the relevant accounting period, without requiring any resolution or decision;

(2) Article 2.1 states that "the Company shall…pay" which obliges the Appellant to pay the prior dividend rather than payment being dependent upon the declaration of a dividend;

(3) The use of the words "shall…pay" is inconsistent with any ability for the directors to avoid payment by not recommending a dividend;

(4) Article 2.3 envisages a separate determination to distribute the balance of any profits; this would be unnecessary if the prior dividend and ordinary dividend were to be effected by the same declaration;

(5) The prior dividend is payable as soon as the "Profits" arise. "Profits" are defined by reference to the audited consolidated profit and loss account. It follows that the prior dividend can only be payable once the Profits as defined are in existence; they are only in existence once the audited consolidated profit and loss account has been completed;

(6) A distinction is to be drawn between when the prior dividend becomes payable and when it is actually due or paid. It follows that any decision as to when the actual payment should be made does not affect the fact that it has already become payable;

(7) The rationale for amending the Articles was in order to qualify for the EIS. This accords with business common sense and so in the event of ambiguity the construction which favours compliance with the EIS should be preferred;

(8) If it is held that the Articles are silent as to when the dividend become payable, it is submitted that an implied term would be required in order to give business efficacy to

the Articles. The implied term ought to be that the dividend becomes payable when the audited consolidated profit and loss account is declared as this would accord with the definition of "Profits" in the Articles as being "as shown in the audited consolidated profit and loss account of the Company in respect of that Accounting Period".

SUBMISSIONS ON BEHALF OF HMRC

23. HMRC submitted that there is a clear preferential right attached to the B Shares so that they do not meet the requirements for relief under s173(2)(a) ITA 2007. Furthermore, as the date on which any such dividend is paid depends on a decision of the director, HMRC submitted that the shares fall within the meaning of s173(2A).

24. S173(2) ITA 2007 contains a requirement that shares "must meet". The requirement is that shares must be ordinary shares which do not at any time during period B carry "any present or future preferential right to dividends that is within subsection 2A" or any preferential right in a winding up.

25. Period B is defined by s 159(3) ITA 2007 as the period during which there must be no preference which is 3 years from the date of issue of the shares; in this case between 18 November 2014 and 18 November 2017.

26. HMRC submitted that a right is preferential within s 173 ITA if the amount of any dividend or the date of the payment of any dividend are dependent to any extent on the decision of the company, the shareholder or any other person.

27. HMRC submitted that in this case, the directors have discretion over the date of payment. The amended Articles state at 2.1 that "the company shall, in priority to the payment of any dividend to all members, pay to the holders of the "B" ordinary shares a prior dividend equivalent to 44% of the profits available for distribution."

28. HMRC contend that the distribution is not straightforward and not a pro rate distribution. The balance of any distributable profit, after the payment of the prior dividend, is at the discretion of the directors.

29. HMRC do not accept that the dividends are simultaneous and that the company must pay out the whole of the profits as dividends with no discretion; there is clear discretion as to if and when a distribution is made.

30. Article 2.1 provides holders of "B" shares a limited share of profits in priority to the other shareholders; HMRC submit that this cannot be ignored.

31. HMRC submit that the Model Articles apply. However, it is submitted that these are subject to any modifications in the Company Articles. The Model Articles give a mechanism to set the amount of the dividend and declare it, while the Company Articles provide the formula for dividing it.

32. Article 2.1 gives the "B" shareholders 44% of distributable profits in preference to any other shareholders; the directors have no discretion in that proportion or priority. The directors can recommend a dividend and have it ratified by the shareholders, at which time it becomes a debt payable to the shareholders. However, the Company Articles then require the division of that dividend to be made in a fixed way. In contrast Article 3 states that the further distribution depends on the determination and recommendation of the directors; it is payable on both "A" and "B" shares.

33. The Articles show a clear preference as to when the "B" dividend should be paid. Article 2.2 states: "in priority to the payment of any dividend to all members" and also refers to a "prior dividend". The use of "Prior dividend" again in Article 2.3 is not an oversight or careless drafting.

34. The "B" shares are subject to a cap of £120,000 per shareholder. HMRC submit this is still a preferential right until the cap is met. "B" shareholders are entitled to a separate dividend that must be paid before any other dividends can be declared. HMRC submitted that there exists the possibility that the Appellant could distribute 44% of its profits to the "B" shareholders then decide that the balance (or part of) will not be distributed to the "A" and "B" shareholders.

35. Furthermore, the date on which the dividend on the "B" shareholding is paid is at the discretion of the directors and therefore falls within s173(2A)(a). The Articles contain no fixed time for the date of paying the Prior Dividend; potentially years could be left between identifying distributable profits and deciding to distribute 44% to the shareholders or it could be done in quick succession.

36. In response to the Appellant's alternative submission that there is an obligation on the Appellant to pay the dividend to the B Shareholders automatically as the wording of the Amended Articles "the company shall….pay to the holders…" can be so construed, HMRC submit that the interpretation to be preferred is that "shall" is read in the context of the words which immediately follow and that its purpose is to ensure the directors pay the preferential dividend in advance of paying anything on the A shares; the word "shall" exclusively relates to the timing of the prior dividend.

37. In the case of *Flix*, the rights on a winding up were considered and it was found that certain shareholders had a preferential right to receive assets before others. In applying *Flix,* HMRC submit that a preferential right is any right to receive assets or dividends in priority to others. The UT in *Flix* also held that the EIS rules must be applied strictly and consistently. It is irrelevant what may or may not be done in practice; the Tribunal must consider what the Appellant could do under its Articles and therefore, it is the precise wording of the Articles which is relevant and not the intention behind the amendments.

38. In *Abingdon* the Ft-T considered shares with a preferential right where the Appellant argued that such a right was contingent and only "purely theoretical" because the preference operated in a winding up and the Appellant did not foresee a winding up as likely. The Tribunal found that the EIS legislation did not require HMRC to consider the likelihood of a preference being fulfilled, only the creation and existence of said preference. It went on to state:

> "the EIS legislation is unambiguous and drafted to give clarity and certainty to all participants as to the conditions for obtaining and retaining relief"

39. HMRC submitted that, as in *Abingdon*, in the current appeal the conditions regarding no preference have been breached. Furthermore, on the facts of this appeal, the preference is not a remote possibility but rather it is operable each time a dividend is declared.

DISCUSSION AND DECISION

40. This appeal raises a point of statutory construction. The facts as set out at [1] – [8] above were not in dispute. The issue in this appeal is whether HMRC were correct in refusing to authorise the Appellant to issue certificates confirming that the ordinary shares in question could benefit from EIS relief. The question to be determined is whether, on a proper construction of s173(2)(a) ITA 2007 the B Shares carried a preferential right to dividends.

41. In order to obtain EIS relief, shares must meet to requirements set out in s173(2). Article 3.1 clearly states that the B Shares do not carry any preferential right to the Appellant's assets

on a winding up. The Articles also do not make provision for the B Shares to carry any preferential right to be redeemed. The B Shares therefore satisfy the requirements of s173(2)(aa) and (b). However, the issue in this appeal arises from the parties' interpretation of the condition contained in s173(2)(a), namely whether the B Shares carry any present or future preferential right to dividends that is within subsection (2A). Section 173(2A) states:

> "A preferential right to dividends carried by a share in a company is within this subsection if—
>
> (a) the amount of any dividends payable pursuant to the right, or the date or dates on which they are payable, depend to any extent on a decision of the company, the holder of the share or any other person…"

42. It is clear from the authorities to which I was referred that the EIS legislation is highly prescriptive and the use of the word "any" preferential right means that any such right, however theoretical or small, should not be ignored.

43. As to purposive construction the UT made the following comments in *HMRC v Trigg (a partner of Tonnant LLP)* [2016] UKUT 165 (TCC):

> "16. The application of purposive construction does not mean that the literal meaning of the statutory language is to be ignored. It will often be – indeed it must be so in the vast majority of cases – that the purpose of a statutory provision which is discerned from the words of the statute will be the same as the literal meaning of those words. The will of Parliament finds its expression in the statutory language. The courts have identified certain types of statutory provision as less susceptible to a purposive construction that does not accord with the literal meaning. As Lewison J said in this tribunal in *Berry v Revenue and Customs Commissioners* [2011] STC 1057, in summarising the development of the *Ramsay* principle, at [31]:
>
> '(vi) … the more comprehensively Parliament sets out the scope of a statutory provision or description, the less room there will be for an appeal to a purpose which is not the literal meaning of the words. (This, I think, is what Arden LJ meant in *Astall v Revenue and Customs Comrs* [2010] STC 137 at [34], 80 TC 22 at [34]. As Lord Hoffmann put it in an article on *'Tax Avoidance'* ([2005] BTR 197): 'It is one thing to give the statute a purposive construction. It is another to rectify the terms of highly prescriptive legislation in order to include provisions which might have been included but are not actually there': see *Mayes v Revenue and Customs Comrs* [2009] EWHC 2443 (Ch) at [30], [2010] STC 1 at [30].)'
>
> 33. We do not consider that it is possible to identify a principle that merely because legislation is closely-articulated, or prescriptive in nature, it is as a general matter somehow less susceptible to a purposive construction. That may be the conclusion that follows from construing a particular provision purposively, but it is not in itself an inhibition on such construction. There may, as Lewison J described in *Berry*, be less room for purposive construction to give a different answer from a literal construction, but that can only be discerned by applying a purposive construction. The principle of purposive construction applies to all legislation, whatever its nature or character. The task for the courts and tribunals, in all cases, is to construe the statutory language of a particular provision in its context and having regard to the scheme of the legislation as a whole in order to ascertain and give effect to its purpose. Even within closely-articulated or prescriptive legislation there may be individual provisions which fall to be construed purposively in a way which would be different from a literal construction. The judgment of the Supreme Court in UBS [*UBS AG & Anor v Revenue and Customs* [2016] UKSC 13 [2016] 1 WLR 1005, [2016] STC 934, [2016] WLR(D) 133] is the most recent example.
>
> 34. That is, however, no more than an exercise of construction. Whatever underlying purpose may be identified, it is not the task of the courts to import a different meaning to the provision

> in question than can properly be attributed to it, merely because of a perception that such a meaning would better suit the purpose so identified. That, to adopt the words of Lord Hoffmann in his *British Tax Review* article in 2005, referred to by Lewison J in *Berry*, would be an exercise in rectification and not construction.
>
> 35. There is also, in our judgment, a distinction between the policy behind, or the reason for, the inclusion of a particular provision in the legislative scheme and the purpose of that provision. Parliament might wish to achieve a particular result as a general matter, and legislate for that reason or in pursuit of that policy. But if the statutory language adopted by Parliament displays a narrower, or more focused, purpose than the more general underlying policy or reason, it is no part of an exercise in purposive construction to give effect to a perceived wider outcome than can properly be borne by the statutory language."

44. It is clear from the wording of the Articles that the B Shares carry a preferential right. At 2.1 the Articles provide for the dividends to be paid to the B Shareholders in priority to the payment of any dividend to all other members. Furthermore, the amount of the dividend pursuant to the preferential right is 44% of the Profits available for distribution and is not restricted to 44% of the amount of any dividends declared. The B Shareholders are therefore in a better position than the A Shareholders as they are not dependent on the amount declared as a dividend (subject to the capping provision in 2.2.5 of the Articles). As I understood the position, this was accepted by the Appellant; the Appellant's position is that the B Shares carry a preferential right but not of the type which is excluded by the legislation.

45. The question that arises for determination therefore is whether the preferential right to dividends falls within s173(2A).

46. The Appellant's position is that the neither the amount of any dividends payable nor dates upon which they are payable depend upon a decision of the company, the holder of the share or any other person. The amount is fixed in Article 2.1 at 44% of the Profits available for distribution and at Article 2.2.2 the prior dividend fixed percentage cannot be altered by resolution of the board of directors or the members. In respect of the dates upon which the dividends are payable, the Appellant relies on the Articles being construed as making the prior dividend payable upon the signing off of the audited consolidated profit and loss account without requiring any resolution or decision. Article 2.1 places an obligation on the company ("shall") to pay the prior dividend rather than payment being dependent on the declaration or recommendation of a dividend.

47. HMRC highlighted the discretion of the directors in respect of the payment of the balance of any profits after the Prior Dividend is paid pursuant to Article 2.3. In my view this does not have the effect of placing the preferential shares within s173(2A) for the following reason; s173(2A)(a) expressly refers to "any dividends payable pursuant to the right". In my view, in reading the section as a whole and in particular the preceding sentence, "pursuant to the right" refers to the dividends payable pursuant to the preferential right. As only the B Shares carry the preferential right, I do not consider that "any dividends", even on a wide construction, includes the ordinary A Shares. Therefore, any discretion or decision by the directors under Article 2.3 which relates to the distribution of the balance of any profits to the A Shareholders does not determine whether the preferential B Shares fall within s173(2A).

48. I am satisfied, and HMRC appeared to accept, that the division of the dividends payable pursuant to the preferential right is fixed and cannot be altered by the directors or members. In those circumstances I have concluded that the first element of s173(2A)(a) which requires the amount of any dividends payable pursuant to the right to depend on a decision by the company, shareholder or any other person, is not satisfied as the shares do not carry a preferential right within s173(2A)(a) in relation to the amount of dividends payable.

49. The second requirement of the legislation is whether the date or dates on which any such dividends are payable depends on a decision by the company, shareholder or any other person.

50. I considered the Model Articles for private companies limited by shares which provide for the procedure for declaring dividends at paragraph 30 as follows:

> "The company may by ordinary resolution declare dividends, and the directors may decide to pay interim dividends.
>
> A dividend must not be declared unless the directors have made a recommendation as to its amount…
>
> Unless the shareholders' resolution to declare or directors' decision to pay a dividend…specify otherwise, it must be paid by reference to each shareholder's holding of shares on the date of the resolution or decision to declare or pay it…"

51. In Palmer's Company Law chapter 6 at 6.1 it states:

> "Preferential shares almost always carry a preferential right to a fixed dividend…But like all rights this right only applies if there are distributable profits lawfully available to the company. <u>The right is not to a dividend but to preferential treatment if and when one is distributed.</u> That in turn depends upon the terms of the articles as to whether this right only arises when a dividend is declared. The articles may provide that provided there are distributable profits a preference dividend should be distributed…Alternatively they may provide that the preference dividend shall be declared by the directors rather than by general meeting. This gives the directors a discretion. In other cases the articles may provide that the preferential dividend is deemed to be due on certain dates". (emphasis added)

52. Mr Chapman highlighted the distinction between the right arising when dividends become payable rather than when paid. He submitted that the obligation arises as soon as profits exist. Mr Chapman submitted that the Prior Dividends are triggered on completion of the audited profit and loss account without being dependent on a decision by the company, shareholder or any other person. HMRC did not recognise this distinction between paid and payable, instead relying on the date of payment as satisfying the requirement in the legislation that there be a decision by the company shareholder or any other person.

53. Having considered the legislation, I agree with the Appellant; it seems to me that there is a distinction to be drawn between the date or dates upon which the dividends are payable or, to put it another way, become due as opposed to the date on which payment is made. If that interpretation is correct then any decision as to the date of payment has no bearing on the fact of the dividends becoming due as a debt. This conclusion, it seems to me, is reinforced by the fact that, for example, a dividend is required to be included in a return by reference to the date it was declared as payable and not the date on which it was paid.

54. However, this distinction does not, in my view, determine the issue of when the preferential dividends become payable or due. Article 2.1 obliges the Appellant to pay the prior dividends and mandates payment prior to any dividend to all other members. It is clear that in relation to the dividends payable after the prior dividends the directors have a discretion as to whether to recommend a dividend and the amount of any such dividends by reference to the balance of any Profits (Article 2.3).

55. In relation to the prior dividends the directors have no such discretion as to the amount which is fixed under the terms of the Articles. The Articles also mandate that the prior dividends are paid first but the Articles are silent as to when any prior dividends become payable.

56. Whilst Mr Chapman's submissions were persuasive I am not, on balance, satisfied that the interpretation urged by the Appellant is correct. Construing the wording of the statute purposively, I have concluded that the clear reference in s173(2A) to "the date or dates on which they are payable" requires identification of any such date in the same way as the statute requires identification of the amount of any dividend. As explained in Palmer's Company Law, the right is not to the dividend but to preferential treatment if and when one is distributed. It seems to me, in those circumstances, that the date upon which the dividends become due would require a decision by the company, shareholder or any other person and it is that which triggers the liability to pay. I also consider that the wording of Article 2.2.5 reinforces this view; the reference to an aggregate amount of Prior Dividends seems to me to allow for the possibility of stage payments which, in the absence of any express reference in the Articles to provide for this, would require a decision as to whether interim payments were appropriate and when such payments would become due.

57. I note that the Companies Act 2006 provides that there can be no distributions without sufficient profits and any declaration in those circumstances would be unlawful. This reflects the Court's judgment in *Bond v Barrow* in which, it seems to me, the Court recognised the commercial logic:

> "It is argued that the provisions as to the declaration of a dividend do not apply to shares on which a fixed preferential dividend is payable. In my opinion this is not so. The necessity for the declaration of a dividend as a condition precedent to an action to recover is stated in general terms in Lindley on Companies, 5th Ed p. 437, and, where the reserve fund article applies, it is obvious that such a declaration is essential, for the shareholder has no right to any payment until the corporate body has determined that the money can properly be paid away."

58. If Mr Chapman's argument that the existence of the audited accounts automatically leads to the dividends becoming payable were to succeed, the liability imposed on the Appellant would be such that the shareholders would be legally entitled to recover the prior dividends even if there was insufficient cash to pay those dividends. This does not, in my view, reach a view consistent with business common sense. Although the Articles provide an obligation to pay the Prior Dividends, this obligation can only arise if company law requirements are met. In the absence of the Articles providing that the dividends become payable on a certain date or dates I have concluded that a determination would be required as to what is lawfully available and a declaration of dividends in order for any liability to be triggered and the dividends to become due or payable.

59. I reviewed the Articles to establish how the distributable profits arise or are identified. Article 1.1 provides:

> "Accounting period means an accounting period in respect of which the Company prepares its accounts in accordance with the relevant provisions of the Act…
>
> Auditors means the auditors of the Company from time to time or, if the auditors are unable or unwilling to act in connection with the reference in question, a chartered accountant nominated by the Directors with the consent of an Investor Majority and, in either case, engaged on such terms as the Directors with the consent of an Investor Majority and acting as agent for the Company and each relevant Member shall, in its absolute discretion, see fit…
>
> Profits means the consolidated net profit (if any) of the Company for each Accounting Period as shown in the audited consolidated profit and loss account of the Company…and adjusted (to the extent not already provided for) as follows
>
> …

(d) before making any provision for the payment of any dividend or other distribution declared or paid by the Group

…"

60. The Articles of Association confirm that identification of profits is made by an individual or individuals acting on behalf of the Company. I note the wording of s173(2A) which includes "depend to any extent". If, as the authorities suggest, the legislation has less scope for purposive interpretation due to the "highly articulated" provisions, then in applying a prescriptive reading to the wide scope provided by the words "to any extent" it would seem that the preparation and signing off of the accounts could fall within s173(2A).

61. However, more notable is the reference to "making any provision for the payment of any dividend or other distribution declared or paid by the Group" which on a literal meaning implies a requirement for a declaration by the Company in relation to any dividend or distribution. I note that the Articles also contain the words "or paid" but as set out above, I consider that to reach the point of payment the fact of the dividends becoming lawfully due or payable must first be triggered.

62. For the reasons set out above and having considered the Articles as a whole, the commercial context and business rationale, I have concluded that the correct construction is that the date or dates upon which the Prior Dividends are payable depends on a decision of the company, the holder of the share or any other person on the basis that once the audited accounts are completed, the distributable profits must be identified and a declaration or resolution required by which the dividends become payable. I therefore conclude that the B Shares carry a preferential right of the type which is excluded by s173(2A). I accept that this is contrary to the intention of the Appellant, however the legislation must be applied strictly and the Appellant's intention does not import a different meaning to the provisions as applied.

63. I therefore dismiss the appeal.

Right to apply for permission to appeal

64. 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.

JENNIFER DEAN
TRIBUNAL JUDGE

Release date: 13 November 2019