[2021] UKFTT 107 (TC)

TC08088

Appeal number: TC/2018/02888

CAPITAL GAINS TAX – whether disposal of an asset – yes – whether guarantee rights equated to shares for entrepreneurs' relief – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

MR JOHN TENCONI **Appellant**

- and -

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

TRIBUNAL: JUDGE ANNE FAIRPO

Sitting in public at London on 6 March 2020

The Appellant appeared in person

Mr Marks, litigator for the Respondents

DECISION

Introduction

1. This is an appeal against a closure notice issued by HMRC on 30 January 2018 in the amount of £175,158.59, denying entrepreneurs' relief on a gain.

2. This issues for this Tribunal to decide are:

(1) whether there was a disposal to which capital gains tax applies; and, if so

(2) whether entrepreneurs' relief is available to reduce the gain.

3. Although the relevant relief has now become known as 'business asset disposal relief', in the period under appeal the relief was known as entrepreneurs' relief and it is that term which is used in this decision.

Background

4. The appeal relates to rights in Monarch Assurance Holdings Ltd (MAH). MAH was incorporated on 22 February 1979 and was limited both by share capital and guarantee rights, as it had been incorporated before changes in company law which required companies to have one or the other but not both.

5. The articles of association of MAH provided for two classes of member in the company: shareholder members and investor members. A member could not be a shareholder and an investor member at the same time: if an investor member acquired shares in the company, that member would become a shareholder member only.

6. Only shareholders were to pay or contribute to the capital of the company; investor members were instead required to pay for one or more "distribution rights". Each such distribution right cost £100, which was described in the articles of association as received by MAH "for its own benefit".

7. Shares in MAH had no voting rights (other than as to matters affecting the shares only), and carried the following rights to income and capital:

(1) as to income, the shareholders were entitled to be paid dividends up to the lower of the profits available for distribution and £2,000 (apportioned according to amounts paid up on shares held);

(2) as to capital, the shareholders were entitled to a repayment of their capital on a winding up or reduction of capital.

8. The distribution rights gave general voting rights to the investor members, and the following rights to income and capital:

(1) as to income, the investor members were entitled to share in the profits available for distribution in excess of £2,000 (apportioned according to the number of distribution rights held);

(2) as to capital, the investor members were entitled to share in the surplus assets of MAH after repayment of share capital to the shareholders. They were also entitled on a winding up to a repayment of amounts paid for their distribution rights.

9. The distribution rights of an investor member could be surrendered to the company for a cash payment, or in consideration of the issue of any security in the company, or any other consideration approved by the directors.

10. Shares could be transferred, but only at the discretion of the directors. No provision for the transfer of distribution rights is contained in the articles of association.

11. The appellant became a director of MAH in July 2008 and, in June 2009, became an investor member as he acquired four "distribution rights" for £100 each.

12. During 2015 another company, Soogen Holdings Limited (SHL) wished to purchase the shares of a subsidiary of MAH. At the time, MAH had issued eight distribution rights such that the appellant held 50% of the distribution rights in MAH and therefore held 50% of the voting rights in MAH. It was not disputed that the approval of the investor members would be required for the shares of the subsidiary to be sold to SHL, such that SHL either needed to acquire such approval from a majority of the existing investor members or alternatively acquire distributions rights to enable it to provide such approval.

13. In his grounds of appeal, the appellant stated that "having regard to the fact that [distribution rights] cannot be sold as they are not capable of transfer, the vendor [defined earlier in the grounds as the appellant] formed the view that the best way in which to [enable SHL to acquire the shares of the subsidiary] was to negotiate a consideration from [SHL] in return for voting in favour of the transaction … the method chosen by agreement between the parties was to purport to transfer the beneficial interest in the rights in return for the consideration agreed".

14. In an agreement dated 3 September 2015, the appellant contracted with SHL and a guarantor for SHL in the following terms: in exchange for consideration of £1,000,000, the appellant would sell and SHL would buy the entire beneficial interest in the four distribution rights owned by the appellant in MAH. The appellant warranted that he was the sole legal and beneficial owner of the distribution rights and was entitled to transfer the beneficial title to the rights. Following completion, the appellant would hold the rights as nominee and on trust for SHL and would have no beneficial interest in the rights. He undertook to exercise the voting and other rights attaching to the distribution rights, specifically undertaking to vote in favour of the acquisition by SHL of the shares in the MAH subsidiary. He also undertook to account to SHL for any dividends or other receipts paid in respect of the rights.

15. Around October 2015, the investor members of MAH voted in a general meeting to transfer the shares of the subsidiary to SHL. As a result of the sale, MAH became a shell company and was dissolved on 9 January 2019.

16. The appellant filed a tax return for the 2015/16 tax return on 31 January 2017, including a capital gains tax computation of a gain of £984,204 (after deduction of costs and losses) in respect of the disposal of "4 shares from s. 104 holding". The appellant claimed entrepreneurs' relief on the gain (after deduction of the annual exemption).

17. HMRC opened an enquiry into that return on 7 July 2017. On 30 January 2018, following correspondence, HMRC denied the claim for entrepreneurs' relief on the basis that the statutory conditions for relief were not met. The closure notice charged an amount of £175,158.59.

18. Further representations were then made by the appellant, in particular that there was no disposal and no chargeable gain assessable or, in the alternative that no capital sums which derived from assets were received and so any sums received were not taxable. Following a review by HMRC, the appellant appealed to this Tribunal on 27 April 2018.

Whether HMRC entitled to argue that there was a disposal of rights or any interest in the rights

19. The appellant submitted that HMRC was not allowed to argue that there was a disposal of rights or any interest in the rights as it had accepted in correspondence that there was no such disposal.

20. Specifically, in a review conclusion letter dated 13 November 2018, HMRC stated that the payment received was not for the transfer of the beneficial interest in the distribution rights but, instead, for agreeing to exercise votes attaching to those rights in a particular way. On the same date HMRC agreed that the beneficial interest in the rights was not capable of being transferred and as such no charge arose under s21 of the Taxation of Chargeable Gains Act 1992 ("TCGA 1992").

21. HMRC submitted that the review conclusion letter had made incorrect assertions as to the law due to confusion as to the nature of the company, and that these had subsequently and promptly been retracted. Further, there had been no amendment to the closure notice which was the subject of the appeal as a result of the review conclusion letter. Regardless of this, it was submitted that the Tribunal cannot be prevented from considering whether or not there was a disposal in order to consider whether entrepreneurs' relief is available as contended by the appellant.

Discussion

22. I note that the appellant had completed his tax return for the relevant period on the basis that there was a disposal, but did not appear to consider that he should therefore be prevented from appealing on the basis that there was no such disposal. HMRC's position in correspondence may also have confused matters more than perhaps necessary but I do not consider that either party should be regarded as being prevented from raising arguments in support of their position.

23. The question of whether or not a disposal of rights has arisen is a matter for this Tribunal to decide, irrespective of the position of the parties at different stages in the correspondence.

Whether there was a disposal in accordance with s21 TCGA 1992

24. s21 TCGA 1992 provides as relevant that

> "(1) All forms of property shall be assets for the purposes of this Act, whether situated in the United Kingdom or not, including–
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> (a) options, debts and incorporeal property generally, and
>
> (b) currency, with the exception (subject to express provision to the contrary) of sterling, and
>
> (c) any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired.
>
> (2) For the purposes of this Act–
>
> (a) references to a disposal of an asset include, except where the context otherwise requires, references to a part disposal of an asset, and
>
> (b) there is a part disposal of an asset where an interest or right in or over the asset is created by the disposal, as well as where it subsists before the disposal, and generally, there is a part disposal of an asset where, on a person making a disposal, any description of property derived from the asset remains undisposed of."

Appellant's submissions

25. The appellant submitted that there was no disposal within the meaning of s21 TCGA 1992 because the disposal was not within the scope of any of the sub-sections of s21 TCGA 1992. This was because:

(1) Rights associated with shares are not separately capable of ownership or transfer as they are associated with the ownership of the shares and indivisibly linked to the shares such that only the shares can be transferred or disposed of. Such rights are future conditional or contingent rights at best. The company's governing documents also did not permit the transfer of distribution rights; these rights could only be surrendered to the company.

(2) As the appellant was not the legal owner of any "share" to which the rights attached he could not own or transfer a beneficial interest in those rights.

(3) In *Kirby v Thorn EMI* ([1987] STC 621) ('*Thorn EMI*') the court concluded that "'property' bears the meaning of that which is capable of being owned" for the purposes of s21 and could not be extended to include a person's freedom to trade. As the appellant did not have legal ownership of the rights then he could not have beneficial ownership and could not transfer such ownership either in common law or in equity.

(4) The distribution rights could not amount to a bundle of rights, as submitted by HMRC, as the membership rights did not include distinct

ownership interests derived from a single ownership interest which could be separately disposed of.

(5) The case of *O'Brien v Benson's Hosiery* ([1979] STC 735) ('*Benson*') referred to by HMRC applies only in the context of employment and also related to a two-party arrangement. It was submitted that in this case there would be four parties involved in the contractual arrangements being the appellant, SHL, the company and the other investor members via the articles of association. Further, the case of *Benson* concerned only current rights rather than the future conditional rights involved in this case.

(6) The rights cannot be turned to account because of the third party relationships through the articles of association with the company and the other investor members.

(7) The contract with SHL cannot have created a bare trust over the rights because the beneficiary could not call for a transfer of the trust assets, as the articles do not permit the transfer of these.

HMRC's submissions

26. HMRC submitted that the distribution rights were capable of being an asset for the purposes of s21 TCGA 1992, as that section states that "all forms of property shall be assets for the purposes of this Act", and that a bundle of rights such as these were capable of constituting an asset.

27. The appellant's submission that the rights could not be owned because they could not be transferred was, HMRC submitted, incorrect: the case of *Benson* had confirmed that an unassignable right with no market value could still be regarded as an asset. The beneficial interest in the rights could still be transferred and so the rights could be turned to account. HMRC submitted that this was exactly what was provided for in the agreement between the appellant and SHL.

28. HMRC submitted, therefore, that the position taken by the appellant in his capital gains tax computation with regard to the chargeable gain itself was correct.

29. HMRC submitted in the alternative that there had been a part disposal by the appellant by operation of s21(2)(b), in that the appellant received £400 when the rights were surrendered to MAH and so retained a residual interest in the distribution rights. HMRC submitted that this made no practical difference to the position.

Discussion

30. s21 TCGA 1992 clearly includes "incorporeal property generally" within the scope of assets and, as such, an asset for the purposes of these rules can include rights such as contractual rights.

31. The appellant submitted that the distribution rights were incapable of being owned because they could not be transferred, and because they related to future conditional rights.

32. To this end, he submitted that the decision in *Zim Properties v Proctor* ([1985] STC 90) ('*Zim Properties*') was authority for restricting the decision in *Benson* to contracts of employment. The appellant did not explain what provisions of the decision in *Zim Properties* he relied upon for this assertion, but I note that Warner J specifically stated in *Zim Properties* (at page 104c) that the decision in *Benson* applies outside the realm of employment law, applying it in the context of *Zim Properties* to a claim against solicitors. I also note that the right to bring a claim in law is not transferrable yet the decision in *Zim Properties* makes it clear that such a right is an asset for the purposes of capital gains tax. Whether rights are present contractual rights (as in *Benson*) or future conditional rights is not relevant: it is clear from the case law that the lack of transferability does not prevent rights from being assets for capital gains tax purposes.

33. The appellant also referred to the case of *Hardy v HMRC* ([2016] UKUT 332 (TCC)) ('*Hardy*') as support for his view. In this case, the court concluded that contractual rights did not amount to an asset in their own right because the taxpayer in that case had acquired a qualified beneficial interest in real estate as a result of the particular contract. The contractual rights did not differ from that beneficial interest and so did not constitute an asset in their own right. This is rather different to the present case, where the distribution rights are not contractual rights in respect of the purchase of an asset but, as in *Zim Properties*, are not connected to an underlying asset.

34. The case of *Thorn EMI*, also referred to by the appellant, contrasted property with freedoms arising under law, such as the right to trade. The court held that these were not incorporeal rights within s22 because this could not fit "within the basic concept of an acquisition of an asset with its accretion in value owing to changes in economic circumstances etc, over a period of inflation followed by disposal with a realisation of a chargeable gain" (page 633 a).

35. The distribution rights are clearly not freedoms of that nature but are, instead, rights arising from the corporate governance documents of MAH.

36. There is in my view nothing to prevent the rights from fitting within the basic concept set out in *Thorn EMI*. Although the articles do not permit the rights to be transferred, the governing documents of the company allow the rights to be surrendered to the Company for (inter alia) any consideration on terms which may be agreed with the directors (see, for example, clause 9(d) of the articles).

37. The appellant also submitted variously that no beneficial interest in the rights could be transferred because they were not linked to an underlying asset such as shares and the rights were future conditional rights at best. As already noted above, the courts have concluded that there is no requirement that rights be linked to an asset or that the rights be transferrable in order the disposal of such rights to fall within s21 TCGA. Further, even if the dividend rights might be regarded as future conditional rights, the distribution rights carried an absolute right to a repayment of the consideration contributed per distribution right on a winding up of the company (Article 65) and as such, at a minimum, a beneficial interest in such rights could be

created. For the purposes of s21, there will be a part disposal where an interest or right over the asset is created. It is not specifically necessary that the interest or right pre-exists the disposal.

38. The appellant offered no particular authority for his statement that the fact that the distribution rights cannot be transferred means that they cannot be held on trust; I do not consider that the appellant has not established that the rights cannot be held by him as trustee for SHL. There is no provision in the governing documents of the company which prohibits the rights from being held on trust for a third party. Article 13 states that MAH shall not recognise a person as holding any share or membership right on trust except as required by law, but this is not a prohibition on such rights being held on trust. Indeed, I note that the financial statements of the company for the year ended 31 December 2014 specifically state that one of the extant distribution rights was held by Windsor Reversionary Company Limited "as a nominee and trustee" for Monarch Assurance Investments Limited. It was clearly considered by the company that the rights could be held by an individual as nominee and trustee for a third party.

39. As such, I find that the distribution rights are property and assets for the purposes of s21 TCGA 1992. Having reviewed the agreement, I do not consider that there was a part disposal of the rights as that agreement clearly states that the appellant transfers all of his beneficial interest and undertakes to account to SHL for any amounts paid to the appellant in respect of the rights.

40. As such, I find that beneficial interest in the rights is capable of being disposed of, within the meaning of s21, and that such beneficial interest was disposed of by the appellant to SHL for the consideration set out in the agreement. As such, a chargeable gain accrued to the appellant in the amount established in his capital gains tax computation before the consideration of any relief.

Whether there was a deemed disposal under s22 TCGA

41. In the alternative, HMRC argued that a deemed disposal arose under s22 TCGA 1992 as the payment by SHL was a capital sum received as consideration for use or exploitation of assets.

42. s22 TCGA 1992 states, as relevant, that:

> "(1) Subject to sections 23 and 26(1), and to any other exceptions in this Act, there is for the purposes of this Act a disposal of assets by their owner where any capital sum is derived from assets notwithstanding that no asset is acquired by the person paying the capital sum, and this subsection applies in particular to–
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> (a) capital sums received by way of compensation for any kind of damage or injury to assets or for the loss, destruction or dissipation of assets or for any depreciation or risk of depreciation of an asset,
>
> (b) capital sums received under a policy of insurance of the risk of any kind of damage or injury to, or the loss or depreciation of, assets,

(c) capital sums received in return for forfeiture or surrender of rights, or for refraining from exercising rights, and

(d) capital sums received as consideration for use or exploitation of assets."

Appellant's submissions

43. The appellant submitted that, as set out above, the rights did not amount to property and therefore could not be an asset and so could not fall within s22 TCGA.

44. The appellant also submitted that, even if the rights did amount to an asset, he had not forfeited, surrendered or refrained from exercising rights. He had voted as he chose to, not because he was required to do so by SHL.

45. SHL was not able to use or exploit the assets because only the appellant was recognised by the company as entitled to vote. The appellant submitted that the reference to "use or exploitation" in s22(1)(d) must mean use or exploitation by SHL. The appellant had voted in favour of the sale for his own purposes and not because of the payment by SHL, and so this could not be a payment within s22(1)(d).

HMRC submissions

46. HMRC submitted that, if there was not a disposal or part disposal under s21 TCGA 1992, that the receipt of the consideration of £1,000,000 by the appellant from SHL was a capital sum received in return for forfeiture or surrender of rights, or for refraining from exercising rights, and so the transaction fell within s22(1)(c) TCGA. HMRC's view was that the consideration was received in exchange for, at least, the exercise by the appellant of his rights in relation to the distribution rights in accordance with SHL's wishes.

47. The consideration was paid in tranches, rather than a single amount, and HMRC submitted that the effect of this is that there would be a deemed disposal at each payment date. As such, the closure notice under appeal would need to be amended to reflect the amount received during that tax year, which was £200,000. Subsequent tranches would be deemed disposals in later years, notwithstanding that such amounts may have been received following surrender of the distribution rights.

Discussion

48. For the reasons set out above, I find that the rights are assets for the purposes of capital gains tax. As such, I do not need to consider this alternative argument but as the parties made submissions in respect of the points arising, I have considered the alternative argument put forward. In essence, the question is whether or not the payment received by the appellant from SHL was received as consideration for the use or exploitation of assets. It was not disputed that the payment was a capital sum.

49. The appellant argued that "use or exploitation" must mean actions by SHL alone. I do not consider that the legislation can be so narrowly interpreted: there is nothing in the wording of the legislation that precludes a charge from arising where a capital sum is received by the owner of the asset for using or exploiting the assets in a particular way. Indeed, I consider that allowing a third party to use the assets would

constitute use and/or exploitation of the assets by the owner. Similarly, exercising rights - including voting rights - as instructed by a third party would be the use and/or exploitation of those rights by the owner.

50. I note the appellant's argument that he exercised his vote in a particular way not because SHL required him to but because he considered that it was the best outcome for the business and that, as a director, he needed to act as a fit and proper person. He stated that he could have voted against the instructions of SHL, and that this would have led to a better result personally, but that he considered it in the best interests of the company to vote in that way.

51. However, the appellant entered into a contract with SHL on 3 September 2015 under which he undertook to exercise all voting rights as SHL directed. The relevant vote took place shortly after the agreement was entered into, and the appellant voted as envisaged in that agreement. The appellant stated that the agreement was entered into because SHL wanted to acquire a subsidiary of MAH and he acknowledged that the agreement had arisen because he had negotiated a payment from SHL in return for voting in favour of the transaction. I do not consider it particularly credible that the appellant had no thought to the agreement in voting for the transaction; in any case, he was paid for refraining from exercising his rights contrary to SHL's wishes and he so refrained. Indeed if, as he states, the appellant considers that he could have voted against SHL's wishes then it is clear from his actions that he did in fact refrain from exercising his rights contrary to SHL's wishes, and he agrees in his grounds of appeal that he was paid to do so. Whether he had any other motive in the way he exercised his rights does not change that.

52. Accordingly, I find that if there was no disposal of the beneficial interest in the rights by the appellant to SHL, there would be a deemed disposal each time that the appellant received a tranche of the consideration and that such consideration would be received for agreeing to exercise his rights as instructed by SHL. I consider that this would therefore be a capital sum received by the appellant as consideration of the use or exploration of the assets and therefore, if this transaction is not an actual disposal under s21 TCGA 1992, it would be a deemed disposal under s22 TCGA 1992.

Whether entrepreneurs' relief applies to the gain on disposal

53. As I have established that there was a disposal for capital gains tax purposes, the question remains whether or not entrepreneurs' relief (as it was at the time) is available in respect of that gain.

54. In order for entrepreneurs' relief to be available, the following statutory provisions apply (in this context):

(1) there must be a disposal of one or more assets consisting of (or interests in) shares or securities of a company (s169I(2)(c) TCGA 1992); and

(2) the company must be the individual's personal company, which means that the individual must hold at least 5% of the ordinary share capital of the company and that the individual holds at least 5% of the voting rights in the company, and that the individual is entitled to either at least 5% of the profits

available for distribution to equity holders and on a winding up would be beneficially entitled to at least 5% of the assets so available, or in the event of a disposal of the whole of the ordinary share capital of the company, the individual would be beneficially entitled to at least 5% of the proceeds (s169S(3) TCGA 1992).

Appellant's submissions

55. The appellant submitted that the distribution rights should be regarded as being shares or securities in the company for the following reasons:

(1) s288 TCGA 1992 states that "shares" includes stock" and so Parliament must have intended a wider meaning than simply shares.

(2) The term "stocks" is sufficient to cover the distribution rights, as is the term "securities", which is not defined in the legislation.

(3) The rights have been treated in the accounts of the company as shareholders' funds in accordance with generally accepted accounting practice, as capital in which the owners of the rights have a share.

(4) The scheme of the legislation is intended to be that beneficiaries of entrepreneurs' relief should be those who have a genuine equity interest in the company and not those who have a debt type interest in the company. In this case, the appellant submitted that it is the Investor Members who have the economic interest and risk equity in the performance of the business. The appellant submitted that the ordinary shares are equivalent to debt and so should be disregarded when considering entrepreneurs' relief. The appellant argued that even if not debt, the shares were entitled to a fixed dividend and so could not be ordinary share capital.

(5) In guidance, HMRC states that the policy objective for changes to the relief is to ensure that the claimant has a material stake in the business, and that the changes are intended to ensure that allowable claims are limited to those within the spirit of the relief.

(6) In the case of *R(Quintalle) v Health Secretary* ([2003] UKHL 13) ("*Quintalle*"), the court noted that "The court's task, within the permissible bounds of interpretation, is to give effect to Parliament's purpose. So the controversial provisions should be read in the historical context of the situation which led to the enactment." The appellant submitted that this was the currently prevailing view and should be applied in this case to read the relevant statute as encompassing guarantee rights.

56. The appellant also made submissions as to the definition of "ordinary share capital" in s989 of the Income Tax Act 2007 ("ITA 2007"). This defines the term as "all of the company's issued share capital (however described)". The appellant submitted that it is clear that the draftsman intended a wide interpretation as the definition subsequently refers only to "capital" such that "issued share capital (however described)" is to be equated with "capital" generally. As such, it was submitted that the term should be read as defining ordinary share capital as being all of the capital of the company other than that excluded.

HMRC submissions

57. HMRC submitted that the legislation is clear that, for entrepreneurs' relief to be available, the interests disposed of in the company must amount to "shares". Where Parliament intends that rights in a company which are not shares should be treated as shares, it states as much in the legislation. For example, in s135(5) TCGA 1992, Parliament provided that non-share interests should be treated as shares for the purposes of reorganisation relief "This section applies in relation to a company that has no share capital as if references to shares in or debentures of the company included any interests in the company possessed by members of the company."

58. HMRC submitted that the distribution rights were not shares, and that this was clear from the provisions of MAH's articles of association. As the appellant had no shares in MAH, they argued that MAH cannot qualify as his personal company by reference to a holding of ordinary share capital. As such, they submitted that the appellant's argument that the distribution rights amounted to securities did not assist him as entrepreneurs' is only available for a disposal of securities in a company which is the personal company of the taxpayer by virtue of a holding of ordinary share capital. HMRC noted that they did not accept that the distribution rights amounted to securities in any case.

59. Further, HMRC submitted that even if the distribution rights could be regarded as share capital for the purposes of the relief, the statutory provisions would still not be met as the appellant would not have 5% of the company. The test is based on the nominal value of capital and, on that basis, the appellant would hold £400 of such capital compared with over £1,000,000 of issued share capital as set out in the accounts of the company. HMRC submitted that the ordinary share capital was not entitled to a fixed rate dividend, and so were not excluded by s989 ITA 2007. The ordinary shares were entitled to participate in dividends up to a value of £2,000 in aggregate: as such, the rate of any dividend declared in respect of the ordinary share capital would vary from 100% (for a distribution of less than £2,000) and then decline as the declared dividend increased above £2,000. As such, the shares would not be excluded from the definition of ordinary share capital, as this excluded only shares which carry a right to a dividend at a fixed rate.

60. HMRC submitted, in summary, that the distribution rights did not amount to share capital and even if they could be regarded as share capital, the appellant did not have a 5% holding. As such, the conditions required for entrepreneurs' relief were not satisfied.

Discussion

Whether the rights should be regarded as shares or securities

61. The distribution rights are clearly set out as guarantee members rights in the articles of association of MAH, and the appellant does not dispute this: his position is that they should nevertheless be regarded as equivalent to ordinary share capital in the context of this case.

62. s989 ITA 2007 states that "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"

63. The appellant's submission that "(however described)" should be interpreted widely is not sustainable: the words in brackets are, in my view, there to assist where companies decide to call one or more of their ordinary share classes by more or less esoteric names (such as "A ordinary shares" or "2020 share option plan shares"). They are not intended to broaden the scope of the term "issued share capital" beyond the capital of the company which relates to issued shares.

64. The accounts refer to the member rights in the list of "Capital and Reserves". They are a separate line item, not included within "called up share capital" or "share premium account". Although the net of capital and reserves is described in the 2014 financial statements as "Shareholders' Funds", I do not consider that this heading alone means that the distribution rights can be considered to be shares. I also note that the 2015 Annual Return for MAH does not include the distribution rights in the Statement of Share Capital.

65. The articles of association state that the amount contributed in exchange for distribution rights is received by the company for its own benefit. That is, it is not received as part of the share capital of the company (Article 8(d)) and investor members are specifically not required to pay or contribute to the capital of the company (Article 8(c)). The articles of association further provide that the only shareholders have a right to a repayment of capital on a winding up; the investor members have only a right to participate in the surplus assets of the company (Article 9(b)), although Article 65 does provide them with a right to be repaid the amount which they had paid to the company for the distribution right. This is not, however, expressed as a right to participate in the capital of the company.

66. Accordingly, I find that the distribution rights are not shares and do not form part of the capital, let alone the issued share capital, of the company. As such, they cannot fall within the definition of "ordinary share capital" in s989 ITA 2007 and entrepreneurs' relief is not available in respect of a disposal relating to those rights. The fact that the term "shares" can encompass "stocks" and "securities" does not mean that it must be considered to also include guarantee members rights such as the distribution rights.

Whether the legislation should be read as encompassing guarantee rights

67. The appellant also submitted that the legislation should be read widely, that the intention of Parliament was to allow entrepreneurs' relief to apply to anyone who held an entrepreneurial interest in a company which resembled share capital even if it did not wholly amount to share capital.

68. The case of *Quintalle*, which the appellant refers to as authority for this proposition that the legislation should be more widely read, relates to scientific advances which were not envisaged when the relevant statute (the Human

Fertilisation and Embryo Act 1990) was enacted. As such, the court was attempting to interpret the relevant statutory provisions in order to accommodate these advances. That is a completely different scenario to the one in this case and, as such, I do not consider that *Quintalle* can be regarded as authority for a wider reading of the statutory provisions relating to entrepreneurs' relief.

69. In this case, the existence of companies which are at least in part limited by guarantee was hardly unknown at the time the relief provisions were designed. There is no need to try to determine what Parliament might have done if it had known about such companies: it did know about them and did not include guarantee rights within the scope of entrepreneurs' relief. The contents of s135(5) TCGA 1992 clearly show that Parliament can make provisions for equating guarantee rights with shares where it considers it appropriate to do so.

70. The appellant submitted that the decision in *Hunter's Property plc v HMRC* ([2018] UKFTT 0096) ("*Hunter's Property*") supported the view that the term "shares and securities" (including stocks) could include guarantee rights under a purposive interpretation. In my view, the decision does nothing of the sort. The question in *Hunter's Property* was whether or not a company limited by guarantee could be a subsidiary for certain tax purposes. The decision was (in summary) that a company limited by guarantee could be a subsidiary in the specific context of that case because the relevant statutory provisions did not refer to share capital in defining the term "subsidiary". There was no purposive interpretation of the statute required: the decision is based on the strict wording of the legislation. The decision rejects submissions aimed at narrowing the scope of the legislation (§47) but that does not mean that the judge has taken a purposive interpretation.

71. I would, however, agree with the statement at §51 of the decision in *Hunter's Property*: that the "way in which Parliament has treated companies limited by guarantee in other contexts does not … assist in the present context". The fact that a company limited by guarantee may be a subsidiary where the definition of such does not refer to share capital does not mean that the rights of guarantee members must be equivalent to shares. Indeed, the decision in *Hunters Property* makes it quite clear that, where the legislation does define a qualifying subsidiary by reference to share capital, a company limited by guarantee cannot be a qualifying subsidiary (see §63).

72. The reference to the interpretation section of TCGA 1992, at s288, also does not assist: if Parliament had intended that "shares" should encompass guarantee rights then I consider that the definition would have plainly included such rights in the definition or, at the very least, included words that made it clear that such a substantially wider interpretation was required.

73. In my view, if entrepreneurs' relief were intended to encompass guarantee members rights (whether in general or where they had characteristics which might resemble share capital), the legislation would have specifically said so. I consider that it would require a contortion of the legislation outside the permissible bounds of statutory interpretation to bring such rights within the scope of the legislation.

Whether MAH could be the appellant's personal company

74. As I have concluded that the distribution rights cannot be regarded as part of the ordinary share capital of the company, it is not strictly necessary to consider whether the appellant would meet the requirements of s169S for MAH to be regarded as his personal company. However, as the parties made submissions on the point, I have considered it.

75. The ordinary shares do not, as submitted by the appellant, have any characteristic of debt nor are they entitled to a fixed rate of dividend: they are entitled to aggregate dividends of up to £2,000 in each financial year such that the rate of dividend paid on the ordinary shares in any given declaration of dividends will depend on the total dividend declared. There is no obligation on the company to pay any dividends, nor to accumulate unpaid dividends and, as such, the rights to dividends of the shareholders cannot be said to be akin to debt rather than equity. The fact that the shares have a limited participation right in respect of dividends and repayment of capital does not make the ordinary shares equivalent to debt. They are plainly the ordinary share capital of the company.

76. Therefore, even if the appellant's distribution rights could be viewed as share capital, the appellant does not have the necessary 5% holding in the company required for entrepreneurs' relief to be available as he would not necessarily be entitled to at least 5% of the profits available for distribution nor 5% of assets on a winding up (where the total distribution declared did not exceed £2,000, or where such assets did not exceed the share capital repayable) nor to 5% of the proceeds on disposal of the whole of the ordinary share capital of MAH.

Decision

77. As set out above, I find that there was an outright disposal by the appellant to SHL of his beneficial interest in the distribution rights within the meaning of s21 TCGA 1992 and, as such, a chargeable gain arose as calculated by the appellant in his tax return.

78. As the appellant's rights in respect of MAH were not shares, and the legislation cannot be viewed as being intended to refer to such rights, I find that the appellant is not entitled to entrepreneurs' relief in respect of that gain.

79. The appeal is therefore dismissed and the closure notice upheld in full.

80. 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.

ANNE FAIRPO
TRIBUNAL JUDGE

RELEASE DATE: 13 APRIL 2021