



Neutral Citation: [2022] UKFTT 141 (TC)

Case Number: TC08472

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

By remote video hearing

Appeal reference: TC/2020/03341

Enterprise Investment Scheme – film production company – risk to capital condition in s.157A ITA07 – whether there was a significant risk of loss of capital – yes – whether the company had objectives to grow and develop its trade in the long term, as opposed to producing a single film or financing a series of individual films – yes – appeal allowed

Heard on: 17 February 2022
Judgment date: 21 April 2022

Before

TRIBUNAL JUDGE KEVIN POOLE

Between

INFERNO FILMS LIMITED

Appellant

and

THE COMMISSIONERS FOR HER MAJESTY’S REVENUE AND CUSTOMS

Respondents

Representation:

For the Appellant: Philip Palmer, Director of the Appellant

For the Respondents: Connor Fallon, litigator of HM Revenue and Customs’ Solicitor’s Office

DECISION

INTRODUCTION

Subject matter of the hearing

1. This appeal concerns the availability of relief under the Enterprise Investment Scheme (“EIS”) in respect of an issue of shares in the Appellant, a company involved in film production. Essentially, HMRC had refused to issue their compliance certificate EIS3 to the Appellant pursuant to section 2014 Income Tax Act 2007 (“ITA07”), on the basis that they considered it did not comply with the “risk to capital” test set out in s157A ITA07 because it did not have objectives to grow and develop its trade in the long term, nor was there a significant risk that there would be a loss of capital by investors of an amount greater than the net investment return.

2. The appeal was therefore concerned with these two issues, though most of the argument revolved around the first of them. HMRC effectively maintained that the Appellant’s business was intended to comprise the financing of one or more individual films on a project by project basis, rather than to develop a meaningful business infrastructure and reputation of its own.

Format of the hearing

3. With the consent of the parties, the hearing was conducted by video link, using the Tribunal’s Video Hearing System. A face to face hearing was not held because of the difficulty of ensuring the safety of all participants. The documents to which I was referred comprised a bundle consisting of 310 pages, an Appellant’s additional bundle consisting of 56 pages and a separate bundle of authorities.

4. Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. As such, the hearing was held in public.

THE FACTS

5. In addition to the two bundles of documents referred to above (and one additional important email from February 2019 referred to below), I heard oral testimony from Philip Palmer (the founder and a director of the Appellant and shareholder in it, his background being as a writer and creative producer in film and television), Michael Riley (a film producer with his own business Sterling Pictures Limited, through which he provided his services as producer of the Appellant’s film “The Ballad of Billy McCrae”) and Kieron Wilkinson (an external investor in the Appellant, who also acted as its chairman).

6. I find the following facts.

7. The Appellant was incorporated on 1 April 2015. It commenced business as a film production company on 12 July 2015. On 21 July and 17 August 2015 and 29 February 2016 it issued shares under the Seed Enterprise Investment Scheme (with HMRC’s approval on each occasion), raising £100,000 in total. It had found “business angel” investors through a Welsh business angel network. These were experienced business people who provided the Appellant with their expertise and experience (Mr Palmer being experienced only on the “creative” side), they were not passive investors just looking for a tax break with minimal risk.

8. On 1 February 2016 the Appellant acquired from Mr Palmer and a company called Afan Films Limited (of which Mr Palmer was described as “co-owner”) all the rights in the unpublished script written by Mr Palmer for the film which has subsequently been made under the name “The Ballad of Billy McCrae” (“BBM”) (there had been previous working titles for the film, namely “Inferno”, “Blood and Stone” and “Red Mist”). It was agreed that Mr Palmer would be paid an initial £10,000 by the Appellant, and when filming started he and Afan would

be paid further amounts, depending on the size of the external investment required to make the film.

9. Information about the Appellant's business activities from early 2016 to early 2019 was sketchy. From the evidence available, however, it appears that the bulk of its energies was taken up with attempting to get its project BBM off the ground, indeed the Appellant confirmed as much in its investment memorandum issued in early 2019 (see [16] below). On 18 April 2016 a "Crew Agreement" was signed between the Appellant and Mr Riley, recording that Mr Riley was being engaged as "Producer" for BBM, with his appointment expected to last until the film was "delivered". He was to be paid a fixed fee of £350 per day (subject to a total cap of £45,000) and was to receive a 5% share of "net profits". He was to receive a credit as producer of BBM, alongside a similar credit for Mr Palmer, and "In Association with Sterling Pictures" was also to appear in the opening credits. Mr Riley was a very experienced producer, with the knowledge and contacts to deal with or arrange all stages of the production process. He had been attracted to join forces with the Appellant because of Mr Palmer's ambition to create a sustainable business and because he valued the Welsh connection it was intended to nurture. At the time of the hearing, he had produced 27 films and was about to start on his 28th.

10. The Appellant's accounts for the two years ended 30 April 2017 and 2018 disclosed little, being small company accounts with no profit and loss accounts or informative notes. All they showed were reductions in the Appellant's shareholders' funds from £48,128 (at 30 April 2016) to £44,261 and £42,203 (for the two following years). I infer that this time was taken up largely with efforts to find further funding and progress the production of BBM.

11. At some point after its initial share issues (possibly as late as early 2019) the Appellant invested £10,000 of its cash into a film called "Sideshow"; the bulk of finance for that film had already been raised but the Appellant's investment provided the final piece of funding that enabled the film to be made. Sideshow was produced by Michael Riley, and both Mr Riley's company Sterling Pictures Limited and the Appellant (under its trading name of "Cymru Films") were credited as production companies for the film. The terms of the Appellant's investment in Sideshow were not explained to me, beyond a statement in the Appellant's documents that it could "yield significant returns... and assists us considerably in branding Cymru Films as a company with two completed movies with distribution deals and imminent UK cinema releases".

12. The document bundle did include an investment memorandum issued by the Appellant in late 2018 or early 2019, in which it was seeking to raise £400,000 by way of external investment. This, it was said, would enable it to make, sell and distribute BBM. The proposal was that the holders of the new shares would, between them, own 50% of the Appellant.

13. The Appellant was not able to achieve its objective with this proposal, as a result of which it returned in early 2019 with a scaled back proposal, seeking to raise a minimum of £50,000 from investors which, with the investment of £30,000 of the Appellant's own funds and agreement for "deferred fees" totalling £300,000 (i.e. fees to be paid out of proceeds from the film once released), would enable the Appellant to make, sell and distribute BBM. As part of this proposal, it appears the identify of the proposed director of BBM was changed.

14. This revised investment memorandum (which described BBM as "the flagship production of Cymru Films") included the following statements:

Investors are being given the opportunity to invest in and own a proportion of Inferno Films Limited (IFL), which trades as Cymru Films. This investment will allow IFL to complete production of our first film, RED MIST.

Investors will also, through their share ownership in IFL, benefit from IFL's investment in the film Sideshow which was produced In Association with Cymru Films.

We are seeking a minimum investment of £50,000 from a share issue which, supplemented by loan capital investment, will allow us to make, sell and distribute the film.

Investors will recoup from first position after loan capital, collection account fee, sales agent marketing expenses and commission. They will also take a share of net profits received by IFL, pro rata and pari passu with other equity investors.

In addition to the above, investors will have the opportunity to visit the set during the shoot in South Wales, watch the process take place, meet the cast and crew and even be an extra in the film. This can also be offered to the investors' nominated family and friends on prior arrangement. Investors will also be invited to the premiere of the film and to UK film festivals it screens at and will receive DVDs/BRDs of the film on its commercial release.

The investment also includes pro rata ownership of the IP – i.e. sequel rights, TV adaptation rights and remake rights, from which the investor would benefit.

In addition, the company will actively develop further new film projects, also set in Wales.

While film investment is obviously not without risks, the Board and producers will do all in their power to ensure the finished movie is as highly marketable as possible. A strong cast, an experienced sales agent and a sensible festival and release strategy are all crucial to the commercial success of a film like this. It is hoped that - aside from the EIS benefits - investors could participate in a reasonable upside of between 10%-30% over 2-3 years of initial exploitation of the film, with a longer tail also generating income for years to come. If the film is very successful, then an upside of over 50% could be achievable. Changes in distribution over the last few years have meant the dominance of such streaming giants as Netflix, Amazon, iTunes and Hulu mean a permanent trickle of income way beyond the shorter income bursts when DVD was king.

15. It is important to remember that the investment memorandum was not a professionally written document with specialist input from lawyers, accountants and financial advisers. It was a story-teller's attempt to capture the vision that Mr Palmer had for the next stage of the Appellant's development. Some speculative financial return figures were given in it, the detail of which is not relevant, except for the statement that "a proportion of distributable reserves will require to be maintained within Cymru Films to fund future growth from further film projects."

16. Finally, under the heading "The journey and next steps", the following text appeared:

RED MIST will shoot in 2019. The shoot will take 18 days (3 x 6 day weeks) and the post-production process (picture and sound edit) will take 12 weeks from the end of filming or 'wrap'. It is our intention to spend as much of the budget as possible in Wales to support the local economy.

Cymru Films will also be packaging and raising finance for a small slate of other Welsh-based projects. One of our strategies will be to develop these projects as star vehicles for the lead actors of RED MIST, with the longer term intention of supporting and promoting the exceptional range of Welsh acting talent in the global marketplace.

To get to this stage of the journey, RED MIST has evolved from the concept of Port Talbot born Philip Palmer into a credible creative project, with a professional team in place ready to deliver a commercially successful film and business.

Since the £100,000 of initial seed investment facilitated through Xenos (now Angels Invest Wales) in 2015, much work has taken place to get to this stage including:

- Purchase of full rights to IP of the Blood & Stone script and movie
- Creation of cinematic trailer for movie and location scouting
- Securing Director, Producer, Sales agent and Casting agent
- Creation of Board team with significant commercial experience
- Re-work of budget and screenplay from original level
- Renaming from ‘Blood and Stone’ and re-casting of film
- Committing to the production of Red Mist
- Investment in the film Sideshow written and Directed by Adam Oldroyd

The team is now ready to create a fantastic film in Wales, involving Welsh people and showcasing as much as possible the incredible scenery and talent of Wales.

This is an opportunity to be part of developing a long term presence in film making in Wales.

17. There then followed a short list of “Potential future films”, giving short details of three further Wales-themed films under consideration.

18. As part of his role as chairman (and a “business angel” investor), Mr Wilkinson was in communication with a contact who was a potential new investor. On 25 February 2019, he emailed him, obviously picking up on earlier contact between them in relation to BBM/the Appellant. After confirming that the film should be starting to shoot in the next few months, he said this:

These investors [*i.e. those who choose to invest in the 2019 financing*] will own part of IFL which is the film production company and will benefit from ongoing profits from Red Mist and from any new films of which we have a number of quality scripts available along with an increased understanding of the industry and contacts within it.

19. In response, on 8 March 2019, the recipient of this email emailed back to confirm that his wife would make a £20,000 investment in the Appellant.

20. On 3 April 2019 the Appellant issued a further 450 shares to 8 investors (including the above new investor in addition to previous shareholders) for a total issue price of £50,000.

21. This successful limited round of fundraising enabled the Appellant to make BBM, using Mr Riley/Sterling Pictures to produce it, whilst retaining all the intellectual property rights in the film itself. It was subsequently released through sales agents in the UK and the USA, having a limited UK cinema release and also being available through various streaming services.

22. As part of the scaled back budget and generally straitened financial situation of the Appellant, further loans of £20,000 were required from some of the investors in order to bring BBM to market, and many of the fees to be paid to those who worked on the film were agreed to be deferred, so as to be paid out of the expected receipts following release of BBM.

23. On 10 June 2019 the Appellant submitted its form EIS1 compliance statement to HMRC in respect of the issue of shares on 3 April 2019, seeking HMRC’s authority to issue certificates to the investors under section 204 Income Tax Act 2007 (“ITA07”), entitling them to EIS relief in respect of their share subscriptions. After raising some questions on the information supplied, and seeking further material, HMRC ultimately issued a decision dated 24 January 2020 refusing to give the relevant authority. The stated reason was because the Appellant “fails the requirement of Section 157A (ITA07)”. This was because HMRC were not satisfied that the Appellant had “objectives to grow and develop its trade in the long term” due to a number of factors, the key ones being the Appellant’s lack of employees (or plans to hire any) and the extent of its subcontracting (leading them to the conclusion that the Appellant was merely acting as the financier of Sterling Pictures for the purposes of a single film project).

24. The Appellant appealed and in their “view of the matter” letter dated 5 June 2020, HMRC confirmed their decision, referring to the use of subcontractors instead of employees as being “against the requirements and intentions of the Risk to Capital Condition”.

25. The Appellant asked for a statutory review of HMRC’s decision, which was concluded on 28 August 2020. In their review conclusion letter, as well as upholding the original decision on essentially the same grounds, HMRC also expressed the view that the fundraising had been intended to finance one single project (the making of BBM) and accordingly they would also have considered the business of the Appellant not to amount to a “qualifying trade” for EIS purposes on the basis that it amounted to “other financial activities” under section 192 ITA07. This latter argument, though repeated in their statement of case, was not pursued by HMRC at the hearing (correctly, in my view).

THE LEGISLATION

26. HMRC maintain that the Appellant does not meet the “risk to capital” condition contained in section 157A ITA07 which provides, in respect of any issue of shares made on or after 15 March 2018, so far as relevant, as follows:

157A Risk-to-capital condition

(1) The risk-to-capital condition is met if, having regard to all the circumstances existing at the time of the issue of the shares, it would be reasonable to conclude that—

(a) the issuing company has objectives to grow and develop its trade in the long-term, and

(b) there is a significant risk that there will be a loss of capital of an amount greater than the net investment return.

(2) For the purposes of subsection (1)(b)—

(a) the risk is to be determined by reference to a loss of capital, and the net investment return, for the investors generally,

(b) the reference to a loss of capital is to a loss of some or all of the amounts subscribed for the shares by the investors, and

(c) the reference to the net investment return is to the net investment return to the investors (whether by way of income or capital growth) taking into account the value of EIS relief.

(3) For the purposes of subsection (1) the circumstances to which regard may be had include—

(a) the extent to which the company's objectives include increasing the number of its employees or the turnover of its trade,

- (b) the nature of the company's sources of income, including the extent to which there is a significant risk of the company not receiving some or all of the income,
- (c) the extent to which the company has or is likely to have assets, or is or could become a party to arrangements for acquiring assets, that could be used to secure financing from any person,
- (d) the extent to which the activities of the company are subcontracted to persons who are not connected with it,
- (e) the nature of the company's ownership structure or management structure, including the extent to which others participate in or devise the structure,
- (f) how any opportunity for investment in the company is marketed, and
- (g) the extent to which arrangements are in place under which opportunities for investments in the company are or may be marketed with, or otherwise associated with, opportunities for investments in other companies or entities.

27. Section 206 ITA07 provides that “[f]or the purpose of the provisions of TMA 1970 relating to appeals, the refusal of an officer to Revenue and Customs to authorise the issue of a compliance certificate is taken to be a decision disallowing a claim issued by the issuing company”. Accordingly, the appeal having been notified to the Tribunal, TMA 1970 provides that the Tribunal “is to determine the matter in question”, namely whether HMRC were entitled to refuse their authority for the issue by the Appellant of the relevant compliance certificates. In order to do so, the Tribunal must therefore form its own view as to whether the “risk to capital” requirements of section 157A ITA07 were satisfied.

28. It is not necessary to set out any further legislation for the purposes of this decision and a broad understanding of the Enterprise Investment Scheme as a whole on the part of the reader is assumed.

THE ISSUES

29. HMRC argued that the Appellant did not satisfy the “risk to capital” condition on two grounds:

- (1) it did not actively grow and develop its trade (and, by implication, it was reasonable to conclude that it did not have such objectives at the time of the share issue) – in effect, it simply raised cash and passed it on to a third party to finance a one-off project;
- (2) it was not reasonable to conclude that there was a risk of loss of capital of an amount greater than an investor’s net capital return. In the skeleton argument, this was justified by reference to the risk of loss being mitigated by the receipt of film tax credit by the Appellant, but this argument was not developed at the hearing.

DISCUSSION AND DECISION

30. The key question before me is whether, having regard to all the circumstances existing as at 3 April 2019, it would be reasonable to conclude that both (a) the Appellant had “objectives to grow and develop its trade in the long-term”, and (b) there was a significant risk that there would be a “loss of capital of an amount greater than the net investment return”.

31. I agree with Mr Fallon that, for the appeal to succeed, the burden lies on the Appellant to satisfy me as to both points.

32. I can dispose of the second point quite briefly. As at 3 April 2019, the prospects of any net investment return to the investors generally (whether by way of income or capital growth)

were extremely speculative. Those prospects depended entirely upon the commercial success of BBM and the subsequent successful use by the Appellant of the resultant proceeds in pursuing its stated aim of developing its business. It was (and remains) perfectly possible that the investors would lose all of the amounts subscribed by them for their shares. This view is unaffected by the availability of film tax credit. I have no hesitation in finding the requirement of s. 157A(1)(b) ITA07 to have been met.

33. The first point (“objectives to grow and develop the trade in the long-term”) requires closer examination.

34. Mr Fallon argued that there were many aspects of the Appellant’s organisation of its business that pointed towards it either being a “single project” company or, at best, a vehicle through which finance was to be provided for a series of individual projects. The clearest evidence of this was contained in the various versions of the investment memorandum, which essentially focused heavily on BBM and had very little of significance to say about plans to develop the business of the company in the longer term. Looking at the specific circumstances identified by way of illustration in s. 157A(3), he submitted the Appellant did not appear to have any intention of taking on employees, acquiring tangible assets for film production (such as camera equipment, production facilities or studio space), the company itself was little more than a shell which sub-contracted all of the activities necessary to produce and distribute BBM, and in his submission the opportunity for investment was marketed as being in respect of BBM rather than the long-term development of the Appellant’s trade.

35. Mr Palmer argued that HMRC were approaching the matter in an entirely uncommercial way, treating the Appellant as if it were a “tyre manufacturer”. For a small newly-founded film production company with very limited financial resources, the only way to build a long-term business was from small beginnings. The Appellant simply did not have (and could not sensibly raise) the money to make more than one film at a time. It was therefore unrealistic to characterise it as a “single project” venture simply because that was the only realistic starting point for it. There was ample evidence before the Tribunal to show that the Appellant did not simply intend to shut up shop and distribute any profits from BBM once it had been made and sold; it had a mission to develop Welsh filmmaking and a number of ideas for its next project down that path if the success of BBM allowed it to move forward, and that was the basis upon which the investors had subscribed for their shares. He referred to the success George Lucas had with his second film “American Graffiti”, which had enabled him to make his next film “Star Wars”; he was not suggesting that the Appellant could follow a similar trajectory, just illustrating that a small initial success in the film world could lead onto much greater things.

36. Equally, he argued that the Appellant’s subcontracting of all the actual film making activity on BBM was a perfectly standard approach in the film industry and, for a company of its size, the only realistic course to follow (indeed, he named at least one very well-known producer who, he said, operated on exactly the same basis). He made reference to the comments made in *CHF Pip! plc v HMRC* [2021] UKFTT 0383 (TC) at [85]: “as a matter of principle it is my view that a company can trade by outsourcing its activities to a third party”, having considered the extensive outsourcing arrangements in place in that case (involving a children’s entertainment TV series). Whilst that appeal had failed on other grounds, he argued that the approach of the Tribunal in that case on the outsourcing point supported the Appellant’s case here.

37. I agree with Mr Palmer, for essentially the reasons he advanced. From the evidence I have seen and heard, I am satisfied that having regard to all the circumstances existing at 3 April 2019 (including those referred to in s. 157A(3) ITA07), it would be reasonable to conclude that the Appellant had at that time objectives to grow and develop its trade in the long

term. This is apparent both from the contemporaneous documents, read as a whole, and from the evidence I heard from Mr Palmer, Mr Riley and Mr Wilkinson. Furthermore, from their evidence I am satisfied that the Appellant has been doing its best to transform those objectives into reality in the period since 3 April 2019. There was a perfectly natural focus in the fundraising document on the immediate project which the Appellant was seeking to bring to fruition, but it is perfectly clear to me that this focus did not detract from the Appellant's intended long term objectives to grow and develop its film production trade by making and releasing a series of further films, as finance allowed, building on the specifically Welsh theme which it was intended to promote.

38. The appeal is therefore ALLOWED. HMRC must accordingly give their authority for the Appellant to issue certificates under s. 204 ITA07 in respect of the shares issued on 3 April 2019 to its investors.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

39. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

**KEVIN POOLE
TRIBUNAL JUDGE**

Release date: 21 APRIL 2022