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GC Trading v HMRC SPC 00630

The first case I want to look at concerns the Enterprise Investment Scheme (EIS). For an individual to qualify for this relief both the investor and the company must satisfy a number of detailed conditions.

The facts of the case are straightforward: two individuals, TG and JC, subscribed for shares in a new company, GCT. GCT acquired a qualifying trade for the purposes of the EIS within the appropriate time limits, using all the funds raised by the subscription. However, between March 1999, the time of the original subscription by TG and JC, and March 2001, when the qualifying trade was acquired, some of the funds held by GCT were loaned out to other companies, including one owned by TG's wife.

The relevant legislation requires shares to be issued to the individual 'in order to raise money for the purpose of a qualifying business activity' (ICTA 1988, s 289(1)(b)) and the money so raised must be 'employed … wholly for the purpose of [that] activity' (s 289(1)(c) and similar wording in TCGA 1992, Schedule 5B).

HMRC denied EIS relief on the basis that the use of the company's funds to make loans to other companies meant that funds had not been employed wholly (or only) for the purpose of the qualifying trade. The company appealed, arguing that all the conditions for the relief were satisfied, that all the money had been invested in a qualifying activity and that the lending of funds at interest was the same as depositing them in a bank account until they could be used.

The Special Commissioner, Adrian Shipwright, followed the decision in *4Cast Ltd v Mitchell* [2005] STC (SCD) 287 SpC 455. In that case, the Special Commissioner, Sir John Avery Jones, had considered the correct interpretation of the phrase 'employed … wholly for the purpose of that activity'. If the money had to be employed wholly, meaning 'only', in acquiring or operating a qualifying activity, as HMRC contended, the appellants must fail, as some of the money had also been used to make the loans. But if the word 'wholly' refers to the *purpose* of the employment of the money, it is the purpose of the directors that must be considered, not the eventual or interim use of the money.

Of particular significance are the words at the end of s 289(3), which say that 'the condition in subsection (1)(c) above does not fail to be satisfied by reason only of the fact that an amount of money which is not significant is employed for another

purpose'. But if an insignificant sum of money is used for another purpose, the money cannot have been used *only* for the business. So the preferred interpretation is that which refers to the purpose of the directors in using the money.

On that analysis, if as a matter of fact the directors of GCT intended the money to be wholly employed for the purposes of a qualifying activity, the fact that it had previously been loaned out at interest would be irrelevant and the EIS relief should be available. The directors' evidence was that the loans were just ways of 'parking' the money until it was needed to acquire the qualifying trade. HMRC did not adduce any evidence to the contrary. The loans were similar to bank deposits, being repayable on demand and carrying interest to prevent erosion of value. So the Special Commissioner concluded that the directors' use of the money was 'entirely consistent with the use of the money wholly for the acquisition of the qualifying trade within the requisite period and makes commercial sense. The loans were a step in the wider purpose of acquiring the qualifying trade … Accordingly, on the particular facts the money raised by GCT from the issue of the shares … was employed wholly by GCT for a qualifying purpose within the requisite period notwithstanding the loans.'

The company won its case.

Comments

This is not just a case demonstrating the nicer points of statutory interpretation. In my opinion it goes to the heart of drafting statute to operate properly in the real world. EIS relief envisages a company raising money by subscription and investing it in a qualifying activity. The time between these two events can be substantial — for GCT it was nearly two years. But the legislation does not consider what a normally commercial person might do with the money in the interim. Indeed, it is only by concession that HMRC permits the money to be deposited in a bank without jeopardising the availability of the relief.

In a remarkable passage from the judgment, Counsel for HMRC was reported to have accepted that 'on this argument even a deposit at interest at bank until the money was needed would disqualify the share issue EIS relief. He said he considers this to fit in with the intention of Parliament to limit the relief and was the effect of the statute'! Personally, I find it staggering that anyone could believe that Parliament intended to restrict the availability of EIS relief in this way. And, if this were so, how could HMRC justify the concession?

The lesson here is about drafting statute and ensuring that it is fit for purpose: that it can provide (in this case) the benefit that Parliament clearly intended and preferably without forcing taxpayers to act in a non-commercial way — keeping the cash under the bed, for example — just for tax reasons.

Lee Barrett v HMRC SPC 00639

This was a case about whether an individual, Mr Barrett, had become non-resident in the 1998–99 year of assessment. Coincidentally, Mr Barrett's case was also heard by Adrian Shipwright.

Mr Barrett had lived and worked in the UK for most of his life. He purported to have been not resident and not ordinarily resident for the year 1998-99, on the basis that he had left the UK before 6 April 1998 and had only returned for brief visits during the year of assessment. As a result, he contended that he was not assessable to income tax for 1998–99.

The legislative provisions are not particularly relevant to this case. The real point is the implementation. That is, did Mr Barrett actually leave the UK to become non-resident and, if he did, could he prove it?

There was a great deal of evidence for the Special Commissioner to consider but much of it was either uninformative or unhelpful to Mr Barrett's case. For example, he was unable to provide any evidence of having left the UK before 6 April 1998. To quote the Special Commissioner's findings of fact: 'He did not have any boarding pass or similar documents or other evidence despite having paid for high powered advice on leaving the UK for tax reasons. I find this surprising to say the least.'

Mr Barrett's bank statements showed entries for purchases and cash withdrawals in and around North and Central London on 6, 7 and 9 April 1998. Then, although Mr Barrett claimed to have visited the UK again for a day trip on 18 April, there was a cash withdrawal in Maida Vale and a payment for car parking at Heathrow Airport on 20 April. There was also a cash withdrawal in Maida Vale on 14 April, although Mr Barrett said he was out of the UK on that day. And there was evidence of frequent visits to the UK throughout the period under review.

So there was real doubt as to when Mr Barrett actually left the UK and whether, when he did, the facts indicated a real change in his lifestyle so as to demonstrate residence abroad.

Other factors that did not help Mr Barrett's case included the fact that his wife and children remained in the UK, he retained his car and made no arrangements for forwarding post, opening a bank account or registering with a doctor or dentist abroad. Furthermore, he continued to be employed by the same company throughout. He had often worked outside the UK for the company and there was no clear change in the pattern of the work he did during 1998–99.

It seems clear from the report of the case that Mr Barrett did, indeed, spend a large proportion of 1998-99 living in Spain. But, overall, it was too easy for HMRC to persuade the Special Commissioner that Mr Barrett remained in the UK on 6 April and did not cease to be UK-resident in 1998–99.

Comments

It was common ground that Mr Barrett's intended period of residence outside the UK was driven by tax concerns. Unfortunately for Mr Barrett, all the evidence available went against him. He was unable to prove when he left the UK and he was unable to prove that he had really ceased to be resident and ordinarily resident here. In the end, there was no evidence to support Mr Barrett's case and the Special Commissioner had very little choice but to find for HMRC.

Let us leave aside the question of evidence given and contentions made in this extreme case, as there is a serious point to be made here. Whether or not a person's actions or transactions are driven by tax concerns, the filing of tax returns (and for many taxpayers the advance payments of tax) must be based on a proper analysis of the actions or transactions carried out. The lesson here is that the taxpayer has to have done what he says he has done to reach the particular filing position. And he has to be able to produce evidence to prove what he did, if there is an HMRC challenge and he is required to defend his filing position.

R (Oao Coombes) v General Commissioners Of Income Tax (Guildford And Wotton Division) [2006] ECHW 1483 (Admin)

This is an interesting case on the administration of the tax appeals system. Mr Coombes had appealed a case to the General Commissioners. The General Commissioners had found for HMRC on the substantive point — which related to whether Mr Coombes was a settlor of a settlement, so that gains that would otherwise accrue to the trustees of the trust accrued to Mr Coombes instead — which I will not be discussing further. Mr Coombes expressed dissatisfaction with the General Commissioners' decision and asked for a stated case for the opinion of the High Court. After some correspondence the General Commissioners formally refused to state a case, on the basis that no question of law was identified.

The legislation is at Regulation 20 of the General Commissioners (Jurisprudence and Procedure) Regulations 1994. Regulation 20(1) provides that the parties to an appeal 'if dissatisfied with the determination or decision [of the General Commissioners] as being erroneous in point of law, may by notice served on the Clerk require the Tribunal to state and sign a case for the opinion of the High Court'. Regulation 20(3) requires the person 'to identify the question of law on which he requires the case to be stated'.

Mr Coombes accordingly expressed dissatisfaction with the decision of the General Commissioners and requested a case to be stated, in a letter which also set out the points of law which he considered to be relevant to the appeal. The General Commissioners responded by saying that 'For the Commissioners to prepare a Case Stated you must be able to show that the Commissioners applied the law wrongly in your case'.

Later, the General Commissioners said that Regulation 20 'should be read in its entirety', and tied Regulation 20(1) — requiring a party to be dissatisfied with the determination or decision as being erroneous in point of law — with Regulation 20(3) — which requires identification of a question of law to be addressed by the High Court. In essence, the General Commissioners said that they were only required to state a case if Mr Coombes had identified their error in law.

Mr Coombes took his case to judicial review in the High Court. The General Commissioners did not appear and were not represented at the hearing. Mr Justice Lloyd Jones decided the case in a single paragraph, stating that the General Commissioners were simply wrong. There was no statutory requirement for Mr Coombes to identify errors of law, he was merely required to identify questions of law. The judge said: 'It is not the function of the Commissioners to provide a screen or a sifting process as to which matters might proceed on a point of law. The duty of the Commissioners is, when requested, to provide a statement of case to enable questions of law to be presented to the court.'

So Mr Coombes got his stated case and transmitted it to the High Court, where he also won his appeal (see *Coombes v HMRC* [2007] EWHC 3160 (Ch)). So the General Commissioners clearly had got it wrong, at least in the opinion of the High Court.

Comments

It is a pity that this case shows the General Commissioners in an unfavourable light, as I am a great fan of the current system of tax tribunals, which is currently in the process of being completely overhauled.

And one area that will almost certainly change, and which is highlighted in this case, is the current ability to appeal a General Commissioners' or Special Commissioners' decision directly to the High Court without having to seek permission. Under the new Tribunal system an appeal from a decision of the First Tier Tribunal may only be made with the permission of that Tribunal. So a barrier will be imposed to taxpayers' access to justice, particularly if this provision is over-zealously enforced by the new Tribunals.

On the other hand, the report of the judicial review does suggest that the General Commissioners were not as well advised on matters of their legal duties as they might have been. One of the drivers of the revised tribunals system is to increase consistency of decision-making by tribunals across the whole of the UK's legal system. So, had the General Commissioners that heard Mr Coombes' original case been part of the new First Tier Tribunal, perhaps Mr Coombes would not have needed to go through the judicial review process to get his appeal heard.

Conclusion

Again, these are three cases that seem to have gone largely unreported. Yet they contain valuable lessons for stakeholders in the tax system: for HMRC who instruct the Parliamentary draftsmen, in GC Trading; for the taxpayers and their advisers who implement planning, in *Lee Barrett*; and for the tribunal members themselves, in Coombes.

By the way … Harding v HMRC SPC 00608

Readers will recall that I commented on this case in the first Miller's Tales (The Tax Journal, Issue 900, 10 September 2007). Mr Harding had sold his shares in a company in return for a loan note that was a non-QCB on acquisition but was structured so that by the time of redemption the relevant terms would have expired, so that the loan note was intended not to be a QCB at the time of the disposal. The Special Commissioner took the view that the loan note was issued as a non-QCB and remained so despite the fact that one of its terms expired before redemption.

Mr Harding's appeal has just been dismissed by the High Court (see [2008] EWHC 99 (Ch)), where the judge took a purposive approach to the question and decided that the purpose of the legislation was clearly that the loan note remain a non-QCB, having been initially issued as such. This decision was made despite that fact that a literal interpretation might have given the opposite result. This decision is sufficiently interesting as to deserve an article of its own.

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