TC05525

Appeal number: TC/2016/02841

INCOME TAX – Enterprise Investment Scheme relief – withdrawal of relief – whether breach of qualifying condition – ITA 2007 s 173(2)(aa) – whether a preferential right to assets on a winding up is carried during Period B – whether the right is 'so contingent as not to be meaningful' – whether the unlikelihood of a winding up relevant – **Flix Innovations** *discussed – appeal dismissed*

FIRST-TIER TRIBUNAL
TAX CHAMBER

ABINGDON HEALTH LIMITED **Appellant**

- and -

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

TRIBUNAL: JUDGE HEIDI POON
MRS GAY WEBB

Sitting in public at the Tribunal Centre, 11 Albion Street, Leeds, on 18 April 2016, with further submissions on 18 July 2016

Hannah Lynch, Counsel, for the Appellant

Simon Bracegirdle, Presenting Officer of HM Revenue and Customs, for the Respondents

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DECISION

Introduction

1. The Enterprise Investment Scheme ('the EIS') is legislated under Part 5 of the Income Tax Act 2007 ('ITA 2007') to provide for income tax relief for individuals who have subscribed for qualifying shares in qualifying companies.

2. The appeal by Abingdon Health Ltd ('the Company') relates to share subscriptions on the following dates for which eligibility for relief under the EIS has been sought:

(1) 22 March 2012 and 10 April 2012; being part of the same fundraising exercise with one payment being made later (the first share issue or 'the 2012 subscriptions');

(2) 21 January 2013 (the second share issue or 'the 2013 subscriptions');

(3) 13 February 2014 (the third share issue or 'the 2014 subscriptions').

3. The subscribed shares under these share issue events are all classified as Preferred Ordinary £1 shares, (or henceforth 'the EIS shares').

4. The appeal is against HMRC's review conclusion dated 23 March 2015. There are two aspects to the review decision. First, in relation to the 2012 and 2013 share subscriptions, the decision withdrew EIS relief previously authorised. Secondly, in respect of the 2014 share subscriptions, the decision refused to authorise the issue of EIS compliance certificates.

5. The potential tax at stake is up to £165,000 of income tax relief claimed by various investors.

6. The triggering event for the withdrawal of the EIS relief was the creation of a new class of shares in May 2013, designated as 'A' Ordinary 1p shares (henceforth 'A Shares'). The triggering event occurred between the second and third issues of the EIS shares.

The issue for determination

7. For the purposes of this appeal, the focus is on the qualifying provision for EIS relief under s 173(2)(aa) of ITA 2007, which stipulates that to qualify for EIS relief, the shares being acquired must not carry 'any present or future preferential right to a company's assets on its winding up' throughout the requisite qualifying period.

8. Following the creation of the A Shares in May 2013, HMRC assert that the Preferred £1 shares under the EIS now carry such preferential right as provided against by s 173(2)(aa) of ITA 2007, and do not (re 2014 subscriptions) or no longer (re 2012 and 2013 subscriptions) qualify for EIS relief. The appellant disputes this.

9. The central issue for the Tribunal to determine is whether the qualifying condition under s 173(2)(aa) of ITA 2007 has been breached as a result of the creation of the A Shares in May 2013.

The onus and standard of proof

5 10. In relation to the refusal to authorise the issue of compliance certificates for EIS purposes, the onus is on HMRC to show that authorisation should be refused.

11. As regards the withdrawal of the previous relief, the burden of proof rests with the appellant to demonstrate that the relief should be retained.

12. The standard of proof is the ordinary civil standard of the balance of
10 probabilities.

Evidence

13. The appellant called the evidence of the following witnesses:

(1) Mr Richard Marlow, Finance Director of the appellant company;

(2) Dr Christopher Hand, Founder and Chairman of the appellant
15 company;

(3) Mr Brian Spence, Fellow of ICAEW and Member of the Chartered Institute of Arbitration, as expert witness.

14. Mr Marlow and Dr Hand produced witness statements, which were adopted as evidence in chief. Their evidence was supplemented by oral evidence, and they were
20 cross-examined by Officer Bracegirdle. The Tribunal found both to be credible and reliable witnesses. Mr Spence produced an expert report on instruction from the appellant; we found Mr Spence's evidence to be professional and impartial.

15. No witness evidence was put forward on behalf of HMRC.

16. Documentary evidence was provided in a joint bundle, and included the
25 correspondence between the parties in relation to the Scheme, the EIS certificates issued, the Report and Financial Statements of the appellant ended 31 December 2013, and the Articles of Association and Amendments at the material times. The appellant also submitted an electronic version of some of the key documents referred to in Mr Spence's witness report:

30 (1) Unaudited management accounts for the 12 months ended 31 December 2015;

(2) Business Plan for 2012 to 2017;

(3) Minutes to the Audit Committee Meeting on 10 September 2015;

(4) Abingdon Health Group 'Final Report to the Audit Committee on the
35 2014 audit' prepared by Deloitte and dated 4 September 2015;

(5) The Powerpoint presentation dated 15 December 2015 on the Company's 2016 and 2017 Budget;

(6) Enterprise Management Incentives (EMI) Tax Valuation Report, prepared by Deloitte in November 2015.

The relevant legislation

17. The provisions that concern this appeal are under Part 5 (ss 156-257) of ITA 2007, which govern the EIS regime.

Statutory requirements for shares to qualify

18. The appeal turns on the interpretation of s 173 which stipulates the qualifying conditions of the shares for EIS relief:

> '**173 The shares requirement**
>
> (1) The relevant shares must meet 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.'

19. Sub-section 173(2) was amended by s 39 of the Finance Act 2012, whereby paras (a) and (aa) replaced the original para (a), which used to read as follows:

> '**173 [version in force before 6 April 2012]**
>
> (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 or to a company's assets on its winding up, or
>
> (b) any present or future right to be redeemed.'

20. The amendments deal with certain situations in which shares carry preferential rights to dividends as detailed under sub-section (2A) and these amendments apply to shares issued on or after 6 April 2012, subject to transitional provisions under para 22(2) of Sch 7 to FA 2012.

21. While the 22 March 2012 subscriptions pre-dated 6 April 2012 and are governed by the provisions before the amendments, the issue in dispute does not concern preferential rights to dividends. Nothing therefore turns on the distinction between the two versions of s 173 in force before and after 6 April 2012.

22. Section 159 defines ‘Period B’ as the period ‘beginning with the issue of the shares and ending immediately before the termination date relating to the shares’.

23. Section 256 gives the meaning of ‘the termination date’, which is normally ‘the third anniversary of the issue date’, unless the shares are issued before the commencement of a qualifying trade, in which case the termination date is the third anniversary of the commencement of the trade.

The procedure to obtain EIS relief

24. Section 203 provides that an individual can claim EIS relief in respect of an amount subscribed if that individual has received a ‘compliance certificate’ from the issuing company in relation to those shares.

25. Section 204 provides for the conditions under which a ‘compliance certificate’ can be issued. Under s 204(2), it is stated that before issuing a compliance certificate to the subscribers, the issuing company *must* provide HMRC with a ‘compliance statement’ in respect of the issue of shares. Under s 204(3), it is stated that ‘the issuing company must not issue a compliance certificate without the authority of an officer of Revenue and Customs.’

26. Section 205 sets out the information required from the issuing company to be included in a compliance statement for HMRC to decide if authority to issue a compliance certificate can be given.

27. In practice, the statutory provisions for the procedure to obtain EIS relief are implemented through the adoption of the EIS forms known as:

(1) Compliance statement on Form EIS1 – from issuing company to HMRC

(2) Authority to issue a compliance certificate on Form EIS2 – from HMRC to the issuing company

(3) Compliance certificate to an individual investor on Form EIS3 – from the issuing company to the investor.

Appeal against refusal and relief withdrawal

28. Section 206 provides for the right of appeal against the refusal of HMRC to authorise the issue of compliance certificates.

29. Section 234 provides for the withdrawal of any EIS relief which is subsequently found not to have been due. Either the issuing company or an officer of Revenue and Customs can give notice for such a withdrawal.

The facts

Background

30. The appellant company was incorporated in 2008, and its business is in the medical diagnostic sector. Its activities relate to all stages from the research and development to the manufacturing and selling of medical diagnostic equipment and devices for the detection of certain types of cancer.

31. The unique selling point of the Company's devices, as described by the expert witness Mr Spence, is that they can be used at the point of delivery of healthcare and give immediate access to diagnostic data. This means there is no need to send off data for analysis, thereby eliminating or significantly reduce the waiting time for results.

32. The research and development costs of the Company are high and it sought and obtained funding from individuals, organisations and venture capitalists accustomed to investing in this sector.

33. It is part of the management strategy to grow the Company by acquiring businesses engaged in the research areas of interest to Abingdon Health. As a result of this strategy Abingdon Health is the parent company of two subsidiaries: Forsite Diagnostics Ltd, and Molecular Vision Ltd, and is related to a third company known as Serascience Ltd.

34. Abingdon Health is also in a joint venture relationship with Bioscience Ventures Ltd and University of Birmingham with its two subsidiaries. These entities, together with Abingdon Health and its subsidiaries, form a consolidated group.

The 2012 and 2013 share subscriptions under the EIS

35. Between 22 March 2012 and 21 January 2013, the first and second share issue events relevant to this appeal took place (the 2012 and 2013 subscriptions). The total share subscriptions had a value of £251,031, and are all within the class of Preferred Ordinary £1 shares.

36. On 14 March 2013, the appellant applied for the 2012 and 2013 share subscriptions to qualify under the EIS.

37. The application was accompanied by three compliance statements on EIS1, all dated 11 February 2013. Each statement gave the details of the individual investors and the class of shares subscribed. Section 3 of the EIS1 requested information on the issued share capital of the company immediately after the issue of the shares seeking to qualify for EIS relief.

38. The two classes of shares listed under section 3 as at 14 March 2013 were:

(1) Preferred Ordinary £1, and

(2) Ordinary £1.

39. Correspondence between HMRC and the appellant followed in which HMRC requested information concerning the purpose of the share issues and the use of money raised. The requested information was for the purpose of establishing the eligibility of the appellant as a qualifying company under the EIS.

5 40. On 12 December 2013, HMRC issued three EIS2 to authorise the Company to issue compliance certificates on EIS3 to its investors under s 204 of ITA 2007.

41. On each EIS2, the 'termination date' of the subscriptions is stated as follows:

(1) Shares issued on 22 March 2012, termination date is 22 March 2015;

(2) Shares issued on 10 April 2012, termination date is 10 April 2015;

10 (3) Shares issued on 21 January 2013, termination date is 21 January 2016.

42. The significance of the 'termination date' is stated on EIS2 in bold as: 'Until that date, the shares, and the company, must continue to meet all the requirements of the Scheme as summarised on the EIS1. If that is not the case, income tax relief will be withdrawn from investors, and any deferred chargeable gains will be brought back 15 into charge.'

The 2014 share subscriptions

43. On 13 February 2014 the appellant issued 150 Preferred Ordinary £1 Shares for £302,257.

44. On 30 September 2014, the appellant submitted a compliance statement on 20 Form EIS1 for the purpose of requesting authority to issue EIS certificates relating to the 2014 share subscriptions.

45. Section 6 of the EIS1 disclosed a new class of shares, being 10,000 'A' Ordinary 1p shares.

The A Ordinary 1p shares

25 46. The 'A' Ordinary 1p shares were created by a resolution on 28 May 2013. The date of the creation of this new class of shares therefore fell between the second and third share issue events under the EIS.

47. On 28 May 2013, the Company's Articles of Association were amended to give effect to the resolution to create the new class of shares.

30 48. On 17 June 2013, the 10,000 A Shares were allotted to five key management personnel of the Company, namely: Dr Hand, Mr Marlow, the Executive Director Mr Pollard, and two Non-Executive Directors.

49. The subscriptions of the 10,000 A Shares total £5,000. The A Shares are also referred to within the management of the Company as the 'growth shares'.

The Articles of Association as amended on the creation of the A Shares

50. The amendments central to the matters under dispute concern Article 9 in the Company's Articles of Association. The former version of Article 9 adopted by special resolution on 22 March 2012 and by which HMRC had issued EIS2 in respect of the 2012 and 2013 subscriptions reads as follows:

> '**SHARES AND DISTRIBUTIONS**
>
> **9. Dividends**
>
> The profits of the Company available for distribution which the Directors resolve to distribute shall be distributed among the holders of the Equity Shares (pari passu) as if the Preferred Ordinary Shares and Ordinary Shares constituted one class of share and Model articles 30 to 35 shall be construed accordingly.'

51. The amended Article 9 adopted by special resolution passed on 28 May 2013 is complex compared to the one paragraph in the former version. The two key aspects covered by the amended Article 9 are as suggested by the heading: *Dividends and Liquidation Preference*.

52. Articles 9.1 and 9.2 address the 'Dividends' aspect as follows:

> '**9. Dividends and Liquidation Preference**
>
> 9.1 Subject to article 9.2 and 9.3, the profits of the Company available for distribution which the Directors resolve to distribute shall be distributed amongst the holders of the Equity Shares (pari passu) as if the Preferred Ordinary Shares and Ordinary Shares constituted one class of share and Model articles 30 to 35 shall be construed accordingly.
>
> 9.2 Subject to 9.3, the Directors, acting with Investor Consent, may resolve to distribute certain of the profits of the Company available for distribution amongst the holders of the A Ordinary Shares as an independent class of Shares from the Equity Shares. Distributions shall be made pari passu amongst holders of A Ordinary Shares at the time of distribution. Model articles 30 to 35 shall be construed accordingly.'

53. Article 9.3 covers the 'Liquidation Preference' aspect, which is detailed and involved. The contentious provisions under Article 9.3 (a) and 9.3(b) are as follows:

> '9.3. On a return of assets on liquidation, capital reduction or otherwise (other than a conversion or purchase of Shares), the assets of the Company remaining after the payment of its liabilities shall be applied (to the extent that the Company is lawfully able to do so) in the following order of priority:
>
> (a) first, in paying to the holders of the Equity Shares in respect of each Equity Share held a sum equal to the Hurdle Amount divided by the number of Equity Shares in issue, together with a sum equal to any arrears and accruals of any dividend declared in respect of that Equity Share calculated down to (and including) the date of the return of capital and, if there is a shortfall of assets remaining to satisfy such

payments in full, the remaining assets shall be distributed to the holders of the Equity Shares pro rata to the aggregate amounts due under this Article 9.3 to each Equity Share held;

(b) second, if any dividend has previously been declared pursuant to article 9.2, in paying to the holders of the A Ordinary Shares in respect of each A Ordinary Share held any arrears and accruals of such dividend in respect of that A Ordinary Share calculated down to (and including) the date of the return of capital and, if there is a shortfall of assets remaining to satisfy such payments in full, the remaining assets shall be distributed to the holders of the A Ordinary Shares pro rata to the aggregate arrears and accruals due to each such Ordinary Share held; [continue with (c)]'

54. Article 9.3 (c) provides for an amount calculated by formula to both the Equity shareholders and the A Ordinary shareholders as follows:

'(c) third, in paying to the holders of the Equity Shares and the holders of the A Ordinary Shares in respect of each Equity Share and / or each A ordinary Share held the following amounts

Amount per share	**Class**
(X multiplied by Y) /NE	Equity
(X multiplied by Z) / NM	A Ordinary

given by the following formula

X = (C-EI-TDG) where

C is the aggregate of amounts available to be paid to the holders of Equity Shares and the holders of A Ordinary Shares under this Article 9.3,

EI is the aggregate of payments made to the holders of Equity Shares under Article 9.3(a);

TDG is the aggregate of all arrears and accruals of dividends (if any) in respect of A Ordinary Shares paid under Article 9.3 (b) …'

55. Articles 11.1 to 11.8 govern the conversion of Preferred ordinary shares and A Ordinary Shares. Under Article 11.2 provides that '[a]ll of the Preferred Ordinary Shares and A Ordinary Shares shall automatically convert into Ordinary Shares on the date of a Listing.'

56. Article 11.6 provides the trigger of the conversion of A Ordinary Shares into Ordinary Shares as follows:

'**11.6** On conversion pursuant to this article 11 when on the proposed conversion date the aggregate listing offer price (excluding any net sums raised by the Company pursuant to a contemporaneous equity funding on listing) of the Company is greater than the Hurdle Amount, the relevant A Ordinary Shares shall (without any further authority

> than that contained in these Articles) stand converted into Ordinary Shares on the basis of one Ordinary Share for Z A Ordinary Shares held …' (Z is a number to be derived by a formula that is provided under Article 11.6)

5 57. 'Hurdle Amount' is defined as '£8,800,000 plus Net Equity Proceeds' under Article 1 on Interpretation.

HMRC's interpretation of the amended Articles of Association

58. It is HMRC's view that a new ranking order of rights to assets on a winding up was created by the amended Article 9 of the Articles of Association.

10 59. Up to 16 June 2013, the only shares in issue were Preferred Ordinary £1 shares and Ordinary £1 shares. The rights attached to the Preferred Ordinary Shares, for which EIS relief was sought, met the requirements under s 173.

60. On 17 June 2013, the Company issued the A Shares which possess rights on a winding up as set out at paragraph 9.3 of the Articles of Association adopted on 28
15 May 2013. According to paragraph 9.3, on a winding up of the Company, the amount available for distribution is paid in the following order:

> (1) First, the Hurdle Amount to Equity shareholders (i.e. the holders of Preferred Ordinary and Ordinary shares but not the holders of A Ordinary shares).
>
20 > (2) Second, any accrued dividends in respect of the A Ordinary shares.
>
> (3) Third, an amount calculated by formula, to both the Equity shareholders and the A Ordinary shareholders.

61. HMRC's view is that this order of priority therefore gives the Equity shareholders, including the Preferred Ordinary shareholders, a preferential right on a
25 winding up to the assets of the Company compared to the holders of the A Shares.

62. As of 17 June 2013 therefore, HMRC considered the Preferred Ordinary shares ceased to qualify for EIS relief.

Letter and notices by HMRC dated 10 October 2014

63. By letter dated 10 October 2014, HMRC notified the appellant that the EIS
30 shares have breached a qualifying condition under s 173 ITA 2007 following the creation of the A Shares, the effect of which is:

> 'Under clause 9.3 of the revised Articles of Association the equity shares have a preference over the 'A' Ordinary shares. The definition of "Equity shares" includes the Preferred Ordinary shares.'

35 64. Two notices dated 10 October 2014 accompanied the letter. The first gave notice under s 234(3)(b) of ITA 2007 and para 16 Sch 5B TCGA 1992 that the shares issued in 2012 and 2013 are no longer eligible shares for EIS purposes. The grounds for the decision are stated as follows:

> 'Since the EIS1 was authorised the shares now carry a preferential right to the assets of the company contrary to s 173(2) Income Tax Act 2007. That right falls within Period B as defined by s 159 (3) Income Tax Act 2007.'

65. A second notice was issued in relation to the 2014 subscriptions, stating that authority under s 204(3) ITA 2007 to issue certificates under s 203(1) ITA 2007 is refused. The grounds of the decision are as follows:

> 'Following the passing of the resolution on the 19 August 2014 the shares now carry preferential right to the assets of the company contrary to s 173(2) Income Tax Act 2007. That right falls within Period B as defined by s 159(3) Income Tax Act 2007.'

66. The reference to the resolution passed on 19 August 2014 concerns the empowerment of the Directors to allot Preferred Ordinary shares. For all intents and purposes, the version of Article 9 in the Articles of Association adopted by resolution on 19 August 2014 is identical to the version adopted on 28 May 2013. The decision has therefore only made reference to the May 2013 version of Article 9.

The purpose and design of the A Shares from the appellant's perspective

67. By letter dated 7 November 2014, Deloitte, acting on behalf of the appellant responded to HMRC's decision by setting out the features and circumstances under which the A Shares were created. The salient facts, according to Deloitte, are:

> (1) The holders of the shares are not entitled to a dividend or any capital on a winding up until such time as the company's value exceeds the Hurdle Amount, which is defined in the Articles of Association as £8.8 million plus Net Equity Proceeds.
>
> (2) The A Shares were designed to incentivise key employees and had minimal value of £5,000 on acquisition, and would only deliver any value to the holders on a future exit event such as a sale of the entire issue share capital or an IPO [Initial Public Offering] at a value in excess of the Hurdle Amount.
>
> (3) The Hurdle Amount was set at a significant premium to the Company's estimated value at the date the A Shares were issued.
>
> (4) The trading results of the Company for the year ended 31 December 2013 show a loss after tax of £990,090.
>
> (5) The consolidated net assets had decreased from £2.13m to £1.95m as at 31 December 2013 with an overall balance sheet value of £2.84m.
>
> (6) The Company's net assets are therefore significantly below the minimum value of £8.8 million at which the A Shares would participate on a winding up.
>
> (7) That A Shares carry a purely theoretical right to a residue of assets on a winding up.

HMRC Internal Manual on Venture Capital Schemes

68. The appellant asserts that HMRC Manual VCM12020 (henceforth also as 'HMRC guidance') lends support to its interpretation of the right to A Shares being purely theoretical. The paragraphs in the manual relied upon by the appellant are as follows:

> 'A right carried by a share is a preferential right if that right takes priority over a right carried by some other share. Thus where a company has only one class of issued share capital no share carries any preferential right.
>
> The rights carried by ordinary shares may in some cases be preferential as compared with the rights of deferred shares, but this is not necessarily so. In particular, where deferred shares carry a purely theoretical right to a residue of assets in a winding up (for example where, in the case of a very small company, after the first £20million has been distributed to ordinary shareholders the deferred shareholders are entitled to 1p per share) we do not regard the ordinary shares as carrying a preferential right.
>
> There a company has two classes of issued share capital, and dividends are declared on one class but not on the other, the right of the former class is not a preferential right.'

69. Referring to the Manual VCM12020, Deloitte stated that the A Shares were 'in line with the example' given in the manual, since:

> '… until such time that the Company is commercially valued in excess of at least £8.8 million or the value of its balance sheet increases significantly the A Shares carry a purely theoretical right to a residue of assets on a winding up. On this basis we do not believe that the Shares carry the preferential right that s173 is aimed at catching.'

70. If the Hurdle Amount is achieved on an exit event, explained Deloitte, 'the A Shares will participate in a proportion of value that would otherwise have been shared amongst holders of the Shares and Ordinary Shares.' In relation to the participation right, Deloitte stated:

> 'In these circumstances the A Shares therefore achieve the opposite of what s173 is aimed at and rather than giving EIS shareholders a preference or a return greater than they are entitled to they effectively reduce their potential entitlement at some point in the future.'

Basis for asserting that the A Shares only have a 'purely theoretical' right

71. By letter dated 3 December 2014, HMRC rejected the argument that the preferential right can be considered as 'purely theoretical', and that the A Shares can be likened to the example in the HMRC manual.

> 'I do not consider the circumstances in this case mirror the example used. There is clearly an intention that the company's value could exceed £8.8M such that the right attached to the shares could apply. The A Ordinary shares were, after all, introduced as an employee incentive, presumably on the basis that the company's value might

> well exceed £8.8M. I do not consider that the £2.8 million balance sheet figure is far from the £8.8 million trigger and it not unlikely that this figure could increase further. I do not therefore consider the right to be a purely hypothetical right.'

5 72. By letter dated 7 January 2015, Deloitte replied to disagree. The letter is lengthy and covers the general characteristics of share capital with the relevant comments regarding the interpretation of the example in VCM12020 as follows:

> 'The Company has no track record of profitability and based on historic performance it is more likely that net asset value will decrease
> 10 rather than increase. A significant change in the Company's performance will be required before any value is attributed to the A Shares and until such time that this occurs the A Shares are effectively a class of deferred shares i.e. they have no rights. There is absolutely no guarantee that any value will ever be attributed to the A Shares *and*
> 15 *in particular in Period B.*
>
> The price paid for the A Shares reflects the fact that up to a pre-determined threshold they do not participate in any value while they do above that value.' (emphasis added)

Mr Marlow's evidence

20 73. Mr Marlow's witness statement covered similar grounds as those related by Deloitte in respect of the purpose and design of the A Shares.

74. The addendum to his witness statement has four main components, which are summarised under the following headings.

(a) A summary of the structure of the Company and its shareholders

25 75. The main investors of the Company are Imperial Innovations, Dr Chris Hand, the University of Birmingham and two investment funds. They are the Ordinary £1 shareholders.

76. Other shareholders comprise the inventors of the Company's main product and private individuals. Three of these private individuals are Preferred Ordinary £1
30 shareholders, and their subscriptions totalling £426,784 represent 3.3% ownership of the Company, and their investments are affected by the EIS ruling.

77. The A Ordinary shareholders invested a total of £5,000 for the A Shares on 17 June 2013, and had received no benefit from holding these shares.

78. In December 2015, the A Ordinary shares were bought back by the Company at
35 the subscription price and have since been cancelled.

(b) The Company's current state of finances

79. While funding inflows have been negative throughout the period, this has always been envisaged. The Company is supported by investors with 'deep pockets',

notably Imperial Innovations, which has invested into the Company in each year since its initial investment in 2012 and the quantum of their investment is £5.9m over that period.

80. Other shareholders such as the University of Birmingham, and high net worth individuals have significant resources for the Company to call on when faced with a funding deficit.

(c) Likelihood of an involuntary wind up

81. An involuntary windup is a scenario that has never been envisaged by the Company and the management always has long term strategies to look well beyond a 3-year window as evidenced by the business plans produced.

82. The unlikelihood of an involuntary wind up is supported by:

(1) the Company's continuing success at raising equity even though performance was adverse to plan; for example, Imperial Innovations has indicated its continuous support at a board meeting in February 2016.

(2) the Directors' assessment that the business was a going concern throughout the period and in particular as documented during the process to approve the statutory accounts filed in September 2013, 2014, and 2015.

(3) The accounts have been audited by Deloitte who are satisfied with the contents of their going-concern reviews.

(d) Future plans for the Company

83. The Company's strategy has been to invest in and develop technology and medical diagnostic applications. These are long term projects of 3 years plus duration. The Company's intention is to commercialise these applications. The first application, Seralite, a test for multiple myeloma (a blood cancer) has been recently launched.

84. The profitability of the Company is anticipated to improve significanlty with the launch of this product. According to the Business Plan produced for the five years to 2017, turnover of the Company is projected to reach £30 million by the end of 2017.

85. Mr Marlow states that given the explanation about funding, the management would not consider the possibility of selling the trade and assets for a value below the Hurdle Amount set in the Articles of Association

86. The long-term plan of the management is to float the Company on AIM (Alternative Investments Market) as evidenced by the business plans produced.

Dr Hand's evidence

87. As the Chairman and founder of the Company, Dr Hand spoke of the reasons for the creation of the A shares, which he referred to as the 'growth shares'. He

described the growth shares as 'a management incentive tool designed to reward management in the event that the business was sold for a price above a target level'.

88. His witness statement emphasised that it was never intended that the growth share scheme would create any preferred rights for other share classes.

89. In respect of 'the principle' of the growth share scheme, and how it was intended to work, Dr Hand stated the following:

> (1) the growth shareholders would receive a share of the upside in the event that the Company was sold;
>
> (2) if the Company was sold for less than the target amount – no impact on the equity shareholders;
>
> (3) if the Company was sold for more than the target amount – the equity shareholders would receive less than they would have done if the growth shares had not been issued;
>
> (4) in all circumstances (other than a sale above the target amount or a wind-up recouping a sum greater than the target amount) the growth shares were an irrelevance.

90. Dr Hand described 'the substance of the arrangement' is that the growth shares put the EIS shareholders in a worse position than they otherwise would have been if the growth shares had not been issued. That being the case, it clearly contradicts the contention that the EIS shareholders enjoyed preferential rights.

91. Speaking of the advice that underpinned the implementation of the growth share scheme, Dr Hand stated that 'the specialist advice from a reputable 'Big 4' accountant in Deloitte' was sought, and that Deloitte 'continue to believe their technical view to be correct'. Deloitte have also indicated that they have at least one precedent where a similar growth share scheme has been implemented without compromising EIS status.

92. Dr Hand stated that Deloitte is not prepared to share this precedent in case that other company may lose its EIS status too. 'It would seem that [to] be acting consistently and fairly HMRC should apply the same rules to Abingdon Health Ltd' is the conclusion drawn by Dr Hand.

93. Dr Hand also spoke of a meeting with HMRC and Deloitte in which Deloitte set out their arguments. Instead of responding to those arguments, HMRC had noted that 'this was a black and white issue with no room for judgement'.

94. In evidence, Dr Hand confirmed that no dividends had ever been declared given that there had been no profits made by the Company so far to declare dividends; that there was no intention to distribute dividends to any class of shareholders, including the growth shareholders.

95. In terms of the relevance of Article 9.3 in the amended Articles of Association, Dr Hand confirmed that he could not foresee a situation that the Company would be wound up because the whole purpose of the Company was to achieve enhanced value

for the shares when it is listed so that the shares can be 'freely traded'. The purpose of the A Shares was to incentivise the management to achieve a sale for the Company above the target level, with 'the sale including a listing on the public market'.

96. Dr Hand also confirmed that he could personally underwrite the Company to prevent it from getting into involuntary liquidation; that he could keep the Company going with his personal funds for two or three years.

97. In cross- examination, Dr Hand was referred to what he had stated in his witness statement – that if the Company sold for less than the target amount, there would be no impact on the equity shareholders. It is then put to Dr Hand –

> Mr Bracegirdle: 'The fact that there is be no impact on the equity shareholders meant that there is a preference created.'
>
> Dr Hand replied: 'We would *not* sell the Company for less than the target value.'

98. In re-examination, Dr Hand confirmed that he agreed with Mr Marlow's view that Article 9.3 would not apply to the sale of the Company. This is so, because Article 9.3 is about a winding up, and the sale of the Company would not be in the form of a winding up. Dr Hand reiterated that the object is to float the Company on AIM, not to sell the Company, but to achieve growth and to allow the shareholders to sell their shares if they so wish on the open market.

99. As regards the likelihood of the Company achieving this objective of growth and a listing on AIM, Dr Hand spoke of the team of three founding members (of which he is one) as a highly skilled team with many years of experience in leading the development of medical and diagnostic products. The team would take out a licence on the intellectual property of the products and launch the company onto AIM. That was what the team had done with a different company and a 'similar life cycle' is envisaged for Abingdon Health. Dr Hand himself has also been involved with AIM listed companies, as a director, not a founder.

Mr Spence's expert evidence

100. Mr Spence was instructed to give his opinion on the following matters:

> (1) Whether the A Ordinary shareholders have received a dividend;
>
> (2) Whether the documents I have seen reveal any intention to pay a dividend;
>
> (3) My view of Articles 9.1 to 9.3 of the Articles of Association adopted on 28 May 2013;
>
> (4) The likelihood of an involuntary wind up or liquidation;
>
> (5) Likelihood of a sale of Abingdon or of its business at a value in excess of the 'Hurdle Amount' of £8.8 million.

101. Mr Spence's expert witness report dated 18 April 2016 stands as evidence in chief, and the summary of his opinions is as follows:

> '(a) The A Ordinary shareholders have not received any dividend, whether by way of money or credit. No shareholders of any class have received a dividend. It will be illegal, under section 830 of The Companies Act 2005, for the company to declare dividends because at no time to date has it had distributed profits;
>
> (b) Nothing I have seen in the documentation supplied to me reveals any intention by the company to pay dividends to shareholders, except by way of a distribution on a winding up;
>
> (c) The probability of an involuntary winding up or liquidation on or before 13 February 2017 (the Termination Date of the last issue of shares for which EIS was sought) is less than 50% and declines as each day passes towards that date. This is an opinion based on my professional experience, having examined the documents made available to me;
>
> (d) The probability of a sale of the company above the 'Hurdle Amount' (£8,800,000 per the Articles of Association) is low – less than 30% – because the net asset value of the company (and its consolidated subsidiaries) is less than £5 million based on the unaudited management accounts to 31st December 2015. That net asset value requires adjustment for Goodwill which is currently being amortised over 20 years – a period that in my opinion may be excessive and must be justifiable under Financial Reporting Standard FRS 102, which will apply to the company's 2016 accounts, otherwise the amortisation period is over five years. This is not to say that Abingdon's accounting treatment is incorrect – amortisation is a matter of judgement. Furthermore, the sales forecast for 2017 shows a continuing negative balance on retained profits.
>
> (e) Article 9.3 can only apply on a winding up or capital reduction and in my lay opinion both scenarios are unlikely before the end of Period B – February 2017.'

102. Mr Spence's report does not elaborate much further on the matters regarding dividend distribution other than what he has stated in the executive summary. The main parts of his report address the last three matters in his instructions in much greater detail and which the Tribunal summarises under the following headings.

(a) On Articles 9.1 to 9.3 of the Articles of Association

103. Mr Spence's opinion on Articles 9.1 to 9.3 of the Articles of Association as amended on 28 May 2013 is set out under sections 3.4 to 3.9 of his report. His opinion in this regard is given with the caveat that interpreting legal documents is beyond the sphere of his expertise as an accountant. The key passages of his opinion are as follows:

> '3.6 Articles 9.1 and 9.2 are stated to be "subject to article 9.3" and it is article 9.3 that, in my opinion, may establish a preference for the

> Ordinary and Preferred Ordinary shares to receive a distribution upon a winding up or a capital reduction before the A Ordinary shares.
>
> 3.7 Article 9.3 deals with a return of assets – to shareholders, by the company in three ways, with one exclusion:
>
> - On liquidation
> - Capital reduction
> - Otherwise.'

104. Mr Spence then considers how a company might return assets to shareholders and states that he can think of only four ways:

> (1) The company sells its assets and trade to another business or acquirer. The sales proceeds flow first into the company, then out to the shareholders, leaving the company as a dormant shell with share capital and the value of its share capital as cash at bank until it is wound up and the share capital repaid to shareholders.
>
> This course of action gives rise to a double tax charge: (1) a capital gains tax charge on the company on any gains arising from the sale of the trade and assets; and (2) an income tax charge on shareholders when sale proceeds are received by way of dividend.
>
> Mr Spence believes this course of action is unlikely and indeed the Abingdon Business Plan has an AIM flotation as the exit strategy, not a sale of its trade.
>
> (2) The company is wound up and its assets distributed to shareholders. Mr Spence's opinion is that this is an unlikely scenario, certainly within Period B.
>
> (3) The company buys back shares from members.
>
> (4) Shares are converted by the company from one type or class to another and a payment made to compensate members.

105. Article 9.3 contains the exclusion phrase '... *otherwise than a conversion or purchase of Shares*'. Mr Spence interprets that in the context of a return of assets by a company to its shareholders, the exclusion does not apply if the company converts shares or if it purchases its own shares. In other words, there is no preference if the company buys in its own shares and this is precisely what the company did with the A shares – it purchased them out of capital, because it did not have distributable profits to fund the purchase.

106. Mr Spence's view is that 'Article 9.3 is unlikely to give rise to a preference, has not given rise to a preference in the past and there can be no preference in the future because the articles have been changed.'

107. Mr Spence's final statement as a conclusion to Article 9.3 is as follows:

> 'In the present case my lay opinion is that Article 9.3 could only apply upon a winding up or capital reduction where the distribution is less than £8.8 million – the Hurdle Amount.'

(b) On the likelihood of an involuntary winding up or liquidation

108. Mr Spence first comments on the accounting environment before making his risk assessment on the matter, and excerpts of his report thereon are as follows:

> '3.23 The critical financial issue facing the Group is cash flow management and the directors of Abingdon appear to be well aware of the need to keep funds coming in. … that Abingdon aims to have at least two months' expenditure available at the bank.
>
> …
>
> 3.26 Cash burn is critical to the group's survival. Its liquidity and solvency, and hence its continued 'Going Concern' status, depend not on historical accounts but on the Group's credibility with its investors…
>
> …
>
> 3.31 … historical accounts are of less importance to the future survival of a business than forecasts of the future. … Abingdon Group is high risk but investors have been prepared to take that risk.
>
> …
>
> 3.33 There is undoubtedly a risk that the funding does not materialise and that the company is forced into an involuntary winding up. In my opinion Abingdon is managing that risk, as it has in the past, and has made reasonable assumptions about the future.
>
> 3.34 For that reason I believe that the likelihood of Abingdon Health Limited being wound up before February 2017 is low.'

109. Having stated his opinion that it is unlikely that the Company would wind up before February 2017, Mr Spence goes on to consider the likely financial outcome in the event that the Company were to be wound up, using the figures in the unaudited accounts to 31 December 2015. The observations material to the appellant's case are as follows:

> '3.38 The biggest single asset in Abingdon's balance sheet as at 31st December 2015 is the value of its investments in subsidiaries… [at] a net value of £4.9 million. This figure represents the amount paid by Abingdon to acquire shares in its subsidiaries.
>
> 3.39 However, … for the year to 31st December 2015 [the subsidiaries] had a combined negative net worth of £2,813,704….
>
> 3.40 … Abingdon has paid in excess of the net assets worth of each subsidiary and this was reflected in the 2014 audited consolidated accounts by the recognition of "Goodwill arising on consolidation" of £3.7 million.

110. Mr Spence's conclusion to this matter is that Abingdon is unlikely to realise the book value of its investments upon a winding up, and that the amount that could realistically be realised for shareholders on a break-up valuation basis would be around £1 million. This figure is well short of the 'Hurdle Amount' of £8.8 million and the A Shareholders would receive nothing, and the Equity shareholders would

have suffered a capital loss as the figure of £1 million is well short of the nominal value of their shares and the related share premium account.

(c) On the likelihood of a sale of the shares or the business for more than £8.8 million before 13 February 2017

5 111. Mr Spence first refers to the 'Tax Valuation Report' prepared by Deloitte for EMI (Enterprise Management Incentives) purposes in November 2015 which placed an entirety value on the whole company of £15.5 million, by extrapolating the subscription value of Abingdon shares at £2.217 each.

112. Mr Spence observes that the so-called 'fiscal valuations' (or valuations for tax 10 purposes) can and do vary considerably from commercial valuations, because fiscal valuations have to be prepared in accordance with the statutory provisions under ss 272 and 273 of TCGA 1992, which is not how a potential buyer would value the company's shares.

113. A corporate buyer of shares is interested in the company's earnings potential, 15 particularly in its cash flow. The question a buyer will ask is how long it will take for the company to return the acquisition costs from its cash flow. The 'return' is normally expressed in terms of 'EBITDA' – Earnings Before Interest Tax, Depreciation and Amortisation – which is a means of gauging cash flow.

114. Abingdon's consolidated EBITDA is negative for 2015 and projected EBITDA 20 remains negative throughout 2016 and 2017. Consequently a valuation of Abingdon on the accepted EBITA methodology would be £nil and that is the reason why Deloitte's 'Tax Valuation Report' has not adopted the EBITDA methodology.

115. Mr Spence then poses the question as to why investors were prepared to pay £2.217 per Ordinary share of £0.001 nominal value in May 2015? His answer is that 25 the investors saw the long-term potential to the Group's earnings, and these were existing shareholders and it has to be assumed that they were kept advised of the group's progress, both technical and financial.

116. In the absence of positive earnings, the net assets valuation basis assumes greater importance in share valuations. On a going concern basis, the net asset value 30 of Abingdon at 31 December 2015 is £4.6 million according to the unaudited balance sheet. In addition to the net assets value, Mr Spence considers there must be a value to the intellectual property held by the Company, which he makes a 'lay guess' and estimates it to be less than £4 million.

117. Mr Spence therefore states 'a commercial valuation' of the shares, based on net 35 assets value of £4.6 million plus intellectual property of £4 million, to be not more than £8.6 million. He concludes therefore that a sale of the company's shares or its trade on or before 13 February 2017 is unlikely to exceed the Hurdle Amount of £8.8 million. He further puts the probability of such a sale at less than 30%.

118. In cross-examination, Mr Spence was asked whether he considers Article 9.3 applies whenever there is a liquidation of the Company. The sequence of questions and replies between Mr Bracegirdle and Mr Spence is as follows:

> Mr Spence: One cannot take Article 9.3 separately from (a), (b) and (c); taking the whole of Article 9.3 together, it is only fair to say it only applies when the Hurdle Amount comes to £8.8 million. The alleged preference can only happen when the Hurdle Amount is more than £8.8 million.
>
> Mr Bracegirdle: Why should the preference not apply unless the Hurdle Amount exceeds £8.8 million? [Mr Bracegirdle then referred to the substance of the Article 9.3 (a) (b) and (c).] The A Shareholders only get a share of the assets if the assets get above £8.8 million, subject to any dividends being voted. But below the £8.8 million, the Equity Shareholders get the amount all to themselves. The Article therefore creates a preference in favour of the Preferred and Ordinary shareholders. Do you agree with that?
>
> Mr Spence: Yes.

Mr Marlow's evidence on Article 11 on share conversion

119. Mr Marlow's evidence was adjourned to allow him time to work out the meaning of the provisions under Article 11.6 where the Hurdle Amount is referred to as a trigger for the conversion of A Ordinary Shares into Ordinary Shares. (Article 11 has eight paragraphs, and they together provide for the terms and calculations under which the Preferred Ordinary Shares and the A Ordinary Shares will be converted into Ordinary Shares.)

120. Mr Marlow explained what the provisions mean to the A Shareholders under Article 11.6 by way of two scenarios. First, if the Hurdle Amount is not achieved on the floatation of the Company, what the A Shareholders will get will be the nominal value of the A Shares. There are 10,000 A Ordinary 1p Shares issued for a total subscribed value of £5,000, but the nominal value is only £0.01; 10,000 shares at one pence each will give £100 in total.

121. The second scenario is when the Hurdle Amount is achieved, say at £18.8 million on floatation. (Hurdle Amount is defined as £8.8 million plus Net Equity Proceeds.) Assume £1 per share is achieved at listing and the value of shares allocated to the Equity Shareholders (Preferred Ordinary and Ordinary) will be £17.8 million, leaving £1 million of value to be allocated to the A Shareholders, whose 10,000 A Shares will be converted to Ordinary Shares worth £1 million. A Ordinary 1p Shareholders' share of the proceeds will be £1 million out of the total proceeds of £18.8 million.

122. Mr Marlow also explained the 'Drag Along Option' provided under Article 19.1, whereby if shareholders holding more than 75% of the Equity Shares wish to transfer all of their interest to a bona fide arm's-length purchaser, the selling shareholders shall have the option (Drag Along Option) to require all the other

holders of shares on the date of the request to sell with full title guarantee to the proposed buyer.

Mr Marlow's post-hearing submission

123. By email dated 18 July 2016, Mr Marlow gave further evidence to support his statement that the possibility of insolvency to be remote. He had stated that a fundraising process was ongoing at the time of the hearing, and he would like it to be noted that the fundraising process was completed in July with £3m being invested.

124. Mr Marlow stated that the funds invested were loan notes and therefore had no impact on the position of the Ordinary shares or Preferred Ordinary shares.

HMRC's Case

125. HMRC's position is that to be eligible for EIS relief a number of requirements must be met by the investors, the issuing company, and the shares.

126. Section 173(2) ITA 2007 states that the shares meet the requirement if they 'do not at any time during period B … carry any present or future preferential right to a company's assets on its winding up', period B being three years from the date of the issue of the relevant shares.

127. Whether shares carry a preference is a question of fact. Section 173 does not apply any thresholds, or *de minimis* principle, nor does it give HMRC any option to use a general discretion when applying the conditions.

128. The share requirement is a bright line test. 'Parliament did not intend small or insignificant preferential rights to be ignored when applying s 173(2)(aa)', at [55] of *Flix*. The requirement is one that the relevant shares must meet, but one that the shares in question here do not meet.

129. Article 9.3 sets out the order of priority how assets are to be applied. First, the Equity shareholders would be paid first and up to the Hurdle Amount. Secondly, the A shareholders will be paid any arrears and dividends voted if the Hurdle Amount not achieved. Thirdly, the residue would be divided between Equity and A Ordinary shareholders according to a formula. Article 9 therefore gives preference rights to the Equity shareholders, which included all Preferred Ordinary shares issued under the EIS. As such, this preference means the Preferred Ordinary shares fail to qualify for EIS purposes.

130. The legislation does not require HMRC to consider the likelihood of the preference being fulfilled. That is not relevant. It is the creation of a preference that is in point here.

131. HMRC submit that it has a duty to apply the law correctly and cannot choose to move away from its statutory obligations merely because a certain result may appear unfair. Any discretion to dis-apply the legislation as it stands is limited to cases of

HMRC error, where there is confusion over the legislation or where factors are outside the taxpayer's control. HMRC submit none of those apply here. The share reorganisation was a conscious decision.

132. The skeleton argument states at [53] as follows:

> 'HMRC submit that there is no motive or purpose test to be applied here. The preferential rights were not accidentally written in to the new Articles. They were designed to incentivise key employees.'

133. The EIS legislation is unambiguous and has been drafted with the intention of giving clarity and certainty to all participants as to the conditions for obtaining and retaining relief. In the matter of this appeal, those conditions have clearly been breached.

134. VCM 12020 does allow HRMC to exercise a limited extra-statutory discretion where rights are genuinely purely theoretical. HMRC submit that this discretion is not appropriate here, and the Tribunal has no jurisdiction to require HMRC to exercise this concession.

135. The deferred right of one penny per share given as an example in the guidance does not apply here because the A Ordinary shares carry more than 'theoretical right' to the residue. In the scenario given by Mr Marlow if the Company achieves a listing at £18.8 million, the value of the A Ordinary shares will not be a penny a share.

136. HMRC submit it has been correct to refuse the EIS relief for the share issue on 13 February 2014 and it is correct to withdraw reliefs previously given.

The Appellant's Case

Preliminary matters

137. In her submissions, Miss Lynch highlighted as preliminary matters what seem to be material misunderstandings on the part of Officer Foxwell who has prepared the skeleton argument on behalf of the respondents. Miss Lynch stated that:

> 'The contents of paragraphs 13 and 49 suggest that HMRC is under the impression that the shares over which EIS relief is claimed are the A ordinary shares, when in fact EIS relief is claimed in relation to the relevant issues of preferred ordinary shares.'

138. The relevant paragraphs from HMRC's skeleton argument read as follows:

> '[13] The company's Articles of Association had been amended on 28 May 2013 creating a new class of shares with preferred rights to the assets in a winding up of the company. The shares were issued to five specific employees as opposed to the general investors.'
>
> [49] HMRC submit there would have been no point in issuing the shares to key employees if they held only theoretical rights. HMRC reject the assertion that there were purely theoretical rights attached to these shares.'

139. With reference to [53] of the respondents' skeleton argument which has been quoted above, Miss Lynch submitted that HMRC have 'confused the issues of the reason for the wording of the amended Article 9.3, and the purpose for which the A ordinary shares were created.' She continued, as stated in her skeleton argument that:

> 'In fact, the preferential rights were accidentally written into the new articles: it was not anticipated that re-writing the relevant sections of the Articles to create the A ordinary shares, would impinge upon the ability of the preferred ordinary shareholders to claim income tax relief under the Enterprise Investment Scheme.'

140. On behalf of the appellant, Miss Lynch stated a concern that such misunderstandings may have contributed to decisions by HMRC to refuse and withdraw EIS relief; that the respondents' case is 'marred by misunderstandings'.

The substantive arguments as stated in the skeleton argument

141. The appellant's case is staked on two grounds, namely:

> (1) On the facts, the Preferred Ordinary shareholders have, within the Periods B, no preferential rights over the A Ordinary shareholders on a winding up; and / or
>
> (2) That any such right is 'so contingent as not to be meaningful', within the meaning of the judgment in *Flix Innovations Ltd v HMRC* [2015] UKFTT 558 ('*Flix*').

142. The facts relied upon by the appellant to make its case concern two aspects of its evidence: (a) The A Ordinary shares and rights of those shareholders; (b) the reality of the Company's position.

(a) The A Ordinary shares and the rights of the A Ordinary shareholders

143. The A Ordinary shareholders paid nominal sums totalling £5,000 for their shares. The A shares carry no property rights and no right to dividend.

144. Article 9.2 of the amended Articles of Association makes it clear that A Ordinary shareholders would only ever receive a share of the Company's profit if investors consented to distributing such a share to them.

145. It is the Company's case that a dividend would only have been declared to the A Ordinary shareholders upon a sale above the Hurdle Amount.

(b) The reality of the Company's position

146. The Company's business documents make it clear that it would only pay a dividend to the A Ordinary shareholders upon a sale of the business above the Hurdle Amount of £8.8 million. Should the whole Company be sold, the A Ordinary shareholders would receive a 'payout', although this would not technically take the

form of a dividend. In the document *Abingdon Health Business Plan 2012-2017* at page 23, the amount of the payout is stated as:

> 'If the exit valuation exceeds this hurdle rate, the growth shareholders receive 10% of the value above the hurdle rate.'

5 147. Mr Marlow's evidence makes it clear that the Company is aiming to achieve either a private sale, or to float on the stock market.

148. In these situations, the allegedly preferential right in Article 9.3 would not apply: this is because on any sale of the entire Company or sale of its shares, there would be no wind up.

10 149. Article 9.3 does not apply to a sale of the Company, because this would not be an example of a '*return of assets on liquidation, capital reduction or otherwise*'. Article 9.3 specifically excludes a purchase of shares: see the phrase '*other than a conversion or purchase of shares*.'

150. It is highly unlikely that the Company would be involuntarily wound up, either
15 within Period B for any of the EIS share issues, or at any time in the foreseeable future. This is supported by Mr Marlow's evidence as the Finance Director of the Company, and the expert evidence of Mr Spence.

151. In the event that the Company were involuntarily wound up, this would be because the Company had failed to attract further cash investments. The evidence of
20 Mr Marlow and Dr Hand, however, has demonstrated that continuous funding for the Company is not going to be a problem, and the Business Plan 2012-2017 of the Company shows that the Company 'is managing that risk, as it has in the past, and has made reasonable assumptions about the future', as commented by Mr Spence.

Arguments as presented at oral submissions

25 152. In her oral submissions, Miss Lynch advanced the argument that Article 9.3 does not apply to a sale of the business, but only to a liquidation. Based on the evidence, an involuntary winding up by way of a liquidation is highly unlikely.

153. As a separate matter, the likelihood of a voluntary wind-up does affect whether the alleged preferential right attached to the Preferred Ordinary shares is theoretical.
30 If there is a sale of trade above the Hurdle Amount, or if there is a solvent wind-up, this is not aimed at being caught by s 173(2)(aa) but by shareholders limiting their risk on winding up. The scenario of a sale of business or a solvent wind-up means the A Shareholders simply get a share of the proceeds of sale that their share class is entitled to receive, and there is no preferential right to be said of the Equity shares.
35 The fact that the Preferred Ordinary shares get more is not the same as a preferential right because there is not enough money to go round.

154. Miss Lynch submits that Article 9.3 (a) does not apply to a situation of voluntary liquidation because the Hurdle Amount would not be achieved.

155. Article 9.3 (b), while it is capable of being applied to involuntary liquidation, the evidence is that there would be no arrears or accruals in dividend in the event of an involuntary liquidation, because Article 9.2 requires the 'consent' from other shareholders for any dividend to be declared on the A Shares.

5 156. Referring to *Flix*, where Judge Richards comments on the Guidance VCM12020 at [61] that the example used by HMRC in the guidance would 'seem to be aimed at a completely different situation, namely the situation where the rights of a deferred share to share in assets on a winding [up] are so contingent as not to be meaningful'. Miss Lynch seeks to draw a parallel between the A shares and the Deferred shares in 10 the example used in the guidance in that the A Shareholders invested £5,000 compared to the £425,000 of the Preferred Ordinary shareholders. She submits that the situation of the Preferred Ordinary shareholders in relation to the A Shareholders is analogous to that of the EIS shareholders against the Deferred shareholders in the example cited in the Guidance; that the Preferred Ordinary shareholders stand to lose 15 so much more than the A Ordinary shareholders.

157. In the event of an involuntary liquidation, the rights attached to the A Ordinary shareholders are 'so contingent as not to be meaningful'; all they stand to get back is what they have paid. So the fact that the Preferred Ordinary shares rank ahead of the A Shares does not create a preferential right.

20 158. The Tribunal indicated to Miss Lynch after her submissions that we did not find her arguments accessible or easy to follow, and we asked Miss Lynch to rehearse her arguments, which we summarise as follows:

(1) That HMRC have misunderstood Article 9.3 and are consistently under the impression that Article 9.3 would apply to a sale, which it does not;

25 (2) That the issue of the creation of A Shares and the likelihood of a wind up are two different issues; that the creation of the A Shares has nothing to do with a winding up, but HMRC have confused the issues in their application of s 173 (2)(aa);

(3) That Article 9.3 is only capable of being applied in a solvent wind-up 30 where there is a trade of assets; that the preferential right of the Preferred shareholders is purely theoretical because it requires there being a solvent wind up below the Hurdle Amount; but based on the evidence, the Company would not accept an offer of trade of assets to bring about this event called solvent wind-up; the preferential right to assets is therefore so 35 contingent as not to be meaningful;

(4) In the event of a solvent wind-up, all that the A Ordinary shareholders will receive is 10% of the value above the Hurdle Amount; the Preferred shareholders have no preferential rights to go round;

(5) That based on the evidence, there would not be a situation where there 40 would be involuntary liquidation below the Hurdle Amount either to give rise to a situation where the preferential right can be meaningful;

(6) In the event of an involuntary liquidation, there would be no dividends declared under Article 9.3 (b), and all that the A Ordinary shareholders are entitled to is the £5000 subscriptions, compared to the £425,000 for the Preferred Ordinary shareholders, and that the comparison is analogous to the example in HMRC guidance.

Discussion

159. We should say at the outset that we think Counsel for the appellant has made a valiant effort at arguing what seems to us an impossible case. It is a testimony to such an effort that this decision has become so long.

160. The issue for determination is whether the Preferred Ordinary shares have breached the qualifying condition under s 173(2)(aa) of ITA 2007. We will determine the case and address the parties' arguments by asking:

(1) Whether the Preferred Ordinary shares carry a preferential right to assets on a winding up during the relevant Periods B;

(2) If so, whether the right is so contingent as not to be meaningful; and

(3) Whether the unlikelihood of a winding up is relevant.

Whether a preferential right to assets on a winding up is carried during Period B

161. Of the many documents to which we have been referred, the only relevant document for the purpose of determining this appeal is the amended Articles of Association adopted on 28 May 2013.

162. Article 9 was amended from its predecessor version of one paragraph to being an involved and complicated set of provisions to create a ranking order for distribution. While there is parity of rights between the Preferred Ordinary shares and the Ordinary shares, (together referred to as the Equity shares), there is clearly a disparity of rights created between the Equity shares and the A Ordinary shares.

163. We agree with Mr Spence, that Article 9.3 has to be taken as a whole with its constituent parts (a), (b) and (c). The constituent parts set out the distribution order in no uncertain terms. Miss Lynch has asked the Tribunal to consider the wording of Article 9.3 carefully, and that 'the Articles [9.3(a) to 9.3(c)] are not perhaps worded as clearly as they could have been'.

164. Notwithstanding the wording, there is no ambiguity in the provisions or of the legal intention to create a ranking order by the very words: '*in the following order of priority*'. That order of priority is then clearly set out in the constituent parts (a), (b) and (c) and unmistakably sign-posted by the lead words: *first*, *second*, and *third*.

165. Article 9.3 is preceded by the two paragraphs that set out the rules to govern the distribution of dividends among the Equity shareholders (Article 9.1), and to the A Ordinary shareholders (Article 9.2).

166. Under Article 9.3 (a) the Equity shares have priority over the A Ordinary shares, and this priority gives the Equity shareholders the entitlement up to a sum equal to the Hurdle Amount plus any dividend arrears or accruals declared in their favour. In other words, a sum equal to the Hurdle Amount is 'ear-marked' or ring-fenced for the Equity shareholders, and if the aggregate value of assets falls short of the Hurdle Amount, then the Equity shareholders will take everything there is.

167. Under Article 9.3(b) the A Ordinary shares are entitled to any dividend arrears or accruals declared, but *only after* the entitlement to capital and dividends of the Equity shareholders has been met. On one level, there exists also a preferential right of the Equity shareholders to their dividends over the A Ordinary shareholders, but this preferential order is subject to paragraphs 9.1 and 9.2, in that there have to be dividends voted to either class in the first place, and the preferential right to dividends enjoyed by the Equity shareholders only becomes relevant if both Equity and A Shares have received a voting to dividends.

168. In the event that no dividends are declared for the Equity shares, paragraphs 9.3 (a) and (b) together mean that the Equity shares still have a preferential right to capital distribution up to the Hurdle Amount over the right to dividends of the A Ordinary shares.

169. It is to be noted that Article 9.3(b) gives ranking of the A Shareholders' entitlement in respect of their *dividends only*, and does not provide for distribution of capital to the A Ordinary shareholders. The capital aspect of distribution comes under Article 9.3(c).

170. By way of a formula, Article 9.3(c) provides for how the residue of the aggregate value is to be distributed, and this is after meeting the entitlements of the Equity shareholders (for capital and dividends), and of the A Ordinary shareholders (for dividends only). The formula is written as X = (C- EI- TDG) where:

(1) C is the aggregate amounts available to both holders of Equity and A Ordinary Shares;

(2) EI is the aggregate of payments to holders of Equity shares; i.e. their entitlement to capital up to the Hurdle Amount plus any dividends;

(3) TDG is the aggregate of all arrears and accruals of dividends (if any) in respect of the A Ordinary shares

171. The formula is a confirmation of this ranking order that has been expressed by Article 9.3 (a) and (b). The formula leaves the matter in no uncertain terms that if EI equals to £8.8 million, there will be nothing for TDG and nothing will be left as X to be distributed as residue to either the Equity or the A Shareholders.

172. For the avoidance of doubt, the Tribunal considers that the preferential right assigned to the Equity shareholders exists regardless of whether the Hurdle Amount is reached or not. If the value of C is below the Hurdle Amount, the preferential right to the Equity shareholders is no less real. When C is less than £8.8 million, the Equity shareholders get the full amount of C and nil to the A Shareholders. Below the Hurdle

Amount, the preference is expressed as every pound and penny to the Equity shareholders and not a penny to the A Shareholders. Over the Hurdle Amount, the preference is expressed as having the first claim up to £8.8 million. In either scenario, there is a decided preference in favour of the Equity shareholders.

5 173. The Articles of Association is a legal document, and the amended Articles incorporating the aforesaid Article 9 had met the formality requirements, followed the proper procedure to be legally adopted by the members of the Company, to become an effective legal instrument governing their rights. The adoption of the amended Articles of Association on 28 May 2013 was a genuine legal event with real legal
10 effects. One of these legal effects was the creation of the class of A Ordinary 1p shares, with a consequential effect of creating a disparity between the two classes of shareholders, setting the Equity shareholders (including the subscribers of shares under the EIS) over the A Ordinary shareholders.

174. The Tribunal therefore finds as a fact that by virtue of Article 9 of the amended
15 Articles of Association adopted on 28 May 2015, the Equity shares, which include the Preferred Ordinary shares for which EIS relief was sought, carry preferential rights over the A Ordinary shares to the Company's assets on its winding up.

175. It would seem that there is tacit acceptance on the part of the appellant that the preferential rights created in favour of the Equity shareholders are indeed
20 incontestable. Counsel, in pointing out the misunderstandings of Officer Foxwell's skeleton argument, seems to have admitted as much:

> 'In fact, the preferential rights were accidentally written into the new articles: it was not anticipated that re-writing the relevant sections of the Articles … would impinge on the [claim to EIS relief].'

25 176. The preferential right to assets, however inadvertent at inception, and however inconvenient in retrospect, is attached to the Preferred Ordinary shares, and that preferential right could neither be edited nor ignored during the period the amended Articles were in force, and until such time as the A Ordinary shares were withdrawn by the Company buying them back in December 2015.

30 177. The termination dates of the three subscriptions for which EIS relief had been previously granted are 22 March 2015, 10 April 2015 and 21 January 2016. On the facts, the preferential rights created by the amended Articles of Association adopted on 28 May 2013 are in breach of the qualifying condition under s 173 (2)(aa) ITA 2007, and the withdrawal of the EIS relief is correct in law, as is the refusal to
35 authorise the issue of EIS certificates to the 2014 subscriptions.

Whether the preferential right is so contingent as not to be meaningful

178. We could have determined the case based on our findings of fact as detailed above. The appellant's case, however, seems to be urging on us to make a finding of law to decide if s 173 (2)(aa) can be dis-applied in some situations.

179. The phrase 'so contingent as not to be meaningful' has become like a refrain in the appellant's submissions. This phrase has its origin in Judge Richards' decision in *Flix* at the tribunal of first instance, and is used at [61] in connection with the example given in HMRC guidance VCM 12020, which states:

> 'The rights carried by ordinary shares may in some cases be preferential as compared with the rights of deferred shares, but this is not necessarily so. In particular, where deferred shares carry a purely theoretical right to a residue of assets in a winding up (for example where, in the case of a very small company, after the first £20 million has been distributed to ordinary shareholders the deferred shareholders are entitled to 1p per share) we do not regard the ordinary shares as carrying a preferential right.'

180. Referring to the extracts from HMRC's published guidance, Judge Richards' remark at [61] is: '[these extracts] seem to be aimed at a completely different situation, namely the situation where the rights of a deferred share to share in assets on a winding [up] are so contingent as not to be meaningful'.

181. It is necessary to state that the guidance has no force in law; the example given in the guidance represents HMRC's view of the law, which is not binding on the Tribunal or even on HMRC. The official status of HMRC Internal Manuals is as guidance prepared for HMRC staff, but the manuals are published in order to be compliant with the Freedom of Information Act 2000. The appellant is fully aware of these limitations of the guidance on which it has relied. Nevertheless, Miss Lynch submits that the guidance should be taken into account in deciding how much weight is to be given to the appellant's arguments.

182. The function of the tribunal is to interpret the legislation as enacted, not HMRC's view of the law as represented in the guidance. The only basis upon which the Tribunal can consider the submissions that the preferential right in question is so contingent as not to be meaningful is by reference to the relevant statutory provision.

183. The relevant statutory provision in this case is laudably simple. The share requirement in question under s 173 (2)(aa) has the following components:

(a) the shares are ordinary shares

(b) which do not, at any time during period B,

(c) carry

(d) any present or future preferential right

(e) to a company's assets on its winding up.

184. For the purposes of the current appeal, the operative word would seem to be 'carry'. The most appropriate meaning for 'carry' in the present context as given by the Oxford English Dictionary is: *have as an attribute, property, meaning, consequence, etc.; display, exhibit, involve, imply.*

185. The carrying of a right is therefore an inherent attribute; the right exists regardless of the likelihood of its being actualised or exercised.

186. According to the Oxford English Dictionary, to actualise means 'to make actual or real, to realise in action or description'; to exercise means 'to employ, or to put to practical effect'. The actualisation and exercise of a right is a different matter from the carrying of a right, which is primarily a matter of its existence.

5 187. The operative period is defined as Period B, being the three years from the date of issue of the relevant shares. Period B serves as the referential time frame for the verb 'carry'. The crucial criterion is whether there is any carrying of such right during Period B; the test is of its existence not of its exercise.

188. The crux of the matter therefore has nothing to do with the likelihood of such 10 right being actualised or exercised during Period B.

189. Turning to the adjective in the statutory wording, it is significant that 'any' appears twice in this short provision. First, 'at *any* time during Period B' is in respect of the requisite time for this qualifying condition. Secondly, '*any* present or future preferential right' concerns the very nature of the right in question.

15 190. The adjective 'any' is strategically incorporated into the provision to denote a sharp and clear 'bright line' test for the existence of any such forbidden right, by its nature and within the stipulated time frame. The bright line test is intended to yield only binary results: such right is either present or absent. There is no threshold to consider, no *de minimis* test to apply.

20 191. The Upper Tribunal decision of *Flix* is emphatic as regards the implications of *any* in applying the requirement test under s 173(2)(aa):

> 'Parliament did not say that the right to relief was restricted only as regards shares where the preference rights were significant or material; it specifically said that relief was denied if *any* preferential right to a
> 25 return of capital existed.' (emphasis original)

192. Section 173 is within the statutory framework providing for the EIS regime under Part 5 of ITA 2007, which is found to be a 'closely articulated' piece of legislation by the FTT in *Flix*. The general consensus from case law authorities is that the more prescriptive and formulaic the relevant legislation is, as is the case here with 30 Part 5, the less scope there is for purposive interpretation that will result in a meaning which is different from the literal meaning. (See for example *Mayes v Revenue and Customs Comrs* [2009] EWHC 2443 (Ch); *Astall v Revenue and Customs Comrs* [2009] EWCA Civ 1010; *Berry v Revenue and Customs Comrs* [2011] UKUT 81 (TCC); and *HMRC v Trigg (a partner of Tonnant LLP)* [2016] UKUT 165 (TCC).)

35 193. The Upper Tribunal decision of *Flix* agrees with the conclusion at first instance of the implications of the prescriptive nature of Part 5 ITA 2007 as legislation at [44]:

> '… 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
> 40 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. …'

194. In such 'closely articulated' legislation as Part 5 ITA 2007, any exceptions to the interpretation of its highly prescriptive rules are specifically provided. For example, the related sections under 213 to 215 of ITA 2007 provide for an exception to the total or partial withdrawal of EIS relief 'where the investor receives any value from the issuing company' (s 213). An exception to the withdrawal of the relief is provided under s 214 for 'receipts of insignificant value'. Section 215 defines the meaning of 'receipts of insignificant value' as a receipt either no more than £1,000, or, if more than £1,000, is insignificant in relation to the amount subscribed by the investor for the relevant shares.

195. The Upper Tribunal decision in *Flix* draws the conclusion at [47] that, 'in the context of a detailed and self-contained statutory regime, sections 213-15 ITA 2007 indicate that, where Parliament intended that inconsequential matters should be disregarded, it said so expressly.'

196. Whether it is by construing the specific provision of s173(2)(aa) on its own, or by setting it in the wider context of the design of Part 5 of TTA 2007 as a piece of highly prescriptive and closely articulated legislation, the Tribunal is unable to make any finding in law that will permit a departure from the bright line test that is conferred by the literal meaning of s 173(2)(aa) as analysed above.

197. Given that legislation simply does not provide for the consideration of contingency in any regard, we could have dismissed the appellant's appeal on all grounds, which seem to be all arguing, in various permutations, that the chance of the preferential right arising is so contingent as not to be meaningful.

198. We have, however, as urged on us by Miss Lynch, also considered if the example used by HMRC in their guidance is analogous in any sense to the present case. We dismiss there could be any analogy for three reasons.

199. First, the appellant's position in respect of the contingency argument has changed its course over time. When Deloitte first raised the argument in correspondence with HMRC, the argument focused on the right of the A Shares being 'purely theoretical', and on that level, being analogous to the deferred shares in the guidance example.

200. Counsel seems to have shifted the contingency argument away from the right attached to the A Shares being purely theoretical, to arguing a course of contingency based on the remoteness of a situation arising (by way of an involuntary liquidation) which would give meaning to the disparity right assigned to the Equity shares.

201. This shift in the focus of what is purely theoretical or contingent – from the right to share in the residue attached to the A Shares, to the possibility of a situation giving rise to a preferential right to be exercised by the Equity shares – means that there is no true analogy that can be drawn between the final course of the appellant's argument and the guidance example.

202. Secondly, even if we were to continue on the course of the contingency argument along the proposition advanced by Deloitte, the guidance example is dealing with 'contingent deferred rights in circumstances where those deferred rights were purely theoretical' (at [50] of the UT decision in *Flix*). In the present case, the rights of the A Shares would seem to enjoy quite the opposite prospects.

203. Dr Hand was quite categorical when he stated, 'We would *not* sell the Company for less than the target value.' As the Chairman and founder of the Company, Dr Hand's evidence inspires every confidence that the prospects of the A Shares are anything but contingent or purely theoretical. Dr Hand has consistently referred to the A Shares as the 'growth shares', and has consistently used the term the 'target value' instead of the Hurdle Amount. While terminology is not everything, it is not insignificant in the present context that these A Shares are growth shares in a Company heading towards and beyond the target value.

204. Thirdly, the guidance example deals with a situation 'where deferred shares carry a purely theoretical right to a residue of assets in a winding up'. In the guidance example, the disparity between the ordinary shares and the deferred shares is given as a right to the residue that equates to 1p per share after the first £20 million has been distributed to the ordinary shareholders. In the guidance, the emphasis is on the disparity in quantum of the entitlement between the ordinary shares and the deferred shares. In the present case, the magnitude of disparity is not mirrored by the A Shareholders' right to share the residue as represented by an involved formula under Article 9.3(c) after the first £8.8 million is distributed to the Equity shareholders.

205. We have considered the relevance of any analogy between the guidance example and the present case merely for the sake of completeness. It is our view that the court has no part to play in considering the relevance of contingency in the application of the provisions under s 173 ITA 2007. We have stated as our finding of law that the application of s 173(2)(aa) is a bright line test with no regard to contingency. The contingency argument is derived by the appellant from the guidance example based on what HMRC have referred to as 'a purely theoretical right'. We should state therefore, even if we had found any valid analogy between the guidance example and the present case, the discretion to dis-apply s173(2)(aa) lies with HMRC, and the Tribunal has no jurisdiction to direct the exercise of any such discretion.

Whether the unlikelihood of a winding up is relevant

206. To follow the appellant's arguments has been like a journey in semantics down the meandering stream of contingency. This is not a criticism of the advocacy, but a statement of the difficulty posed by the lack of a legislative handle to wield a meaningful argument staked on contingency.

207. As already related, the consideration of contingency has no statutory basis. The contingency argument would seem to have its origin in HMRC's guidance example, in which the deferred shares is said to have 'a purely theoretical right', and it is in respect of this theoretical right that the remark 'so contingent as not to be meaningful' was made in *Flix*.

208. The final course of the appellant's argument would seem to have taken a different turn from the guidance example. The central tenor of the appellant's argument is not so much that the right attached to the A Shares to participate in sharing the residue of the assets on a winding up is purely theoretical.

209. As we understand it, the main thrust of the appellant's argument is that the amended Article 9.3 only applies in an involuntary liquidation, or in a solvent wind-up where there is a trade of assets. It is only in either situation that the preferential right attached to the Equity shares intended to be caught by s 173(2)(aa) has any meaning.

210. The evidence from the management of the Company has made it amply clear that the prospect of a voluntary winding up by way of a sale of assets is simply not in the plan. The plan has always been to achieve a listing of the kind that will call on the share conversion rights as provided by Article 11 for the Preferred Ordinary and A Ordinary shares to convert into Ordinary Shares. The mechanism of proceeds realisation following such a conversion is as explained by Mr Marlow's oral evidence.

211. There is therefore only the likelihood of an involuntary winding up to consider to assess whether the chance of the preferential right thus arising under Article 9.3 is so contingent as not to be meaningful.

212. The proof of the likelihood of an involuntary liquidation happening, Miss Lynch submits, is referential to the time frame set by the relevant Periods B, and therefore ending at their latest on 13 February 2017 in relation to the 2014 subscriptions for Preferred Ordinary shares.

213. It is argued from the evidence that an involuntary liquidation would only happen if there were to be a cash flow problem for the Company which has a history of negative cash. The case is made that such an involuntary liquidation due to a liquidity issue is highly unlikely in the present case. This is so, not only because of investors' confidence in the Company's prospects, but also because of the expertise and experience of its management to manage risk. Mr Marlow's evidence, including his post-hearing submission, is of the nature to testify the prospect of the Company being able to continue to secure funding for its operation. Dr Hand's evidence spoke of his ability to keep the Company going for two or three years out of his private means. Mr Spence's evidence assesses the Company's future as a going concern from the accounting perspective and his findings based on risk assessment.

214. We accept the appellant's evidence in its entirety. We found all three witnesses gave their evidence with a professional level of integrity. Nevertheless, we have no difficulty in rejecting the argument in its entirety because the premise upon which the argument is built is simply irrelevant for the application of s 173(2)(aa).

215. Our finding in law has concluded that the operative word 'carry' in s 173(2)(aa) does not involve any consideration of whether a preferential right is actualised or exercised. The appellant's argument is staked on the remote possibility of the

preferential right attached to the Equity shares having an opportunity to be actualised under the terms as provided by the amended Article 9.3.

216. The only relevant consideration for s 173(2)(aa) is whether there is any present or future preferential right in a company's winding up being *carried* by the relevant shares in Period B. It is irrelevant to consider the possibility of such a right being actualised in reality.

217. Article 9 was amended to provide for the rights of the newly created A Shares, and the situations envisaged by Article 9 are standard situations covered in an average company's Articles of Association where there are more than one class of shareholders. The management of Abingdon Health might have considered the situations covered by Article 9 as no more than a formality to cover certain remote eventualities. However, the preferential right thus created by covering these eventualities was a legal reality during the currency of that version of Article 9 or until the A Shares were bought back by the Company in December 2015.

218. As Counsel has stated in the skeleton argument, 'the preferential rights were accidentally written into the new articles'; we do not doubt that the preference was inadvertently created. Nevertheless, the decision to create the A Shares was consciously adopted and endorsed by all the members of the Company, and effectively executed by special resolution. Section 173(2)(aa) does not provide for any construction to take account of the 'intention' behind the creation of the preference, any more than it does to permit a construction based on contingency.

219. It is not only from the point of law that there can be no scope to entertain the grounds of appeal based on contingency as advanced by the appellant. From a policy perspective, the EIS regime would be impossible to administer if every decision by an HMRC officer to grant authority for an issue of an EIS certificate would have to involve consideration of contingency.

220. The proceedings in front of us have involved some convoluted processes of assessing probability, of ascertaining the Company's liquidity position for the future, of its long-term prospects towards listing and not a sale, of the strategy, intention and purpose of the management, occasioning voluminous submissions of the Company's accounts and budgets, of funding projections, of five-year business plans, of valuation reports and risk assessments.

221. It would be invidious if the application of s 173(2)(aa) should have involved a similarly complicated process for a decision to be reached by an HMRC officer. Not only would the time and costs be disproportionate in administering such a regime, the process would also be fraught with the potential for protracted litigation. It cannot be Parliament's intention that s 173 (2)(aa) ITA 2007 should be applied in a manner that would lend any support to the appellant's argument based on assessing the likelihood of the preferential right being actualised.

222. Finally, we would address the error in the respondents' skeleton argument, whereby the preferential right is attached to the A Ordinary shares. Counsel for the

appellant submits that the error has given rise to misunderstandings that have marred the respondents' case. The Tribunal agrees that there is this error in the skeleton argument but we do not consider that the error has marred the respondents' case.

223. The preferential right has been wrongly attached to the A Shares as a matter of fact, but the decision of withdrawal and refusal of the EIS relief in respect of the Preferred Ordinary shares is correct as a matter of law. We note also that the various HMRC officers involved in confirming the decision of 10 October 2014 that is the subject of the appeal have not made this factual error, and have consistently shown an appreciation of the fact that the preferential right was attached to the Preferred Ordinary shares for which the EIS relief was sought.

Decision

224. For the reasons stated, the appeal is accordingly dismissed.

225. 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.

DR HEIDI POON
TRIBUNAL JUDGE

RELEASE DATE: 29 NOVEMBER 2016