[2017] UKUT 0344 (TCC)

Appeal number: UT/2016/0141

CAPITAL GAINS TAX – entrepreneurs' relief – TCGA, Part V, Chapter 3 – meaning of "personal company" – TCGA, s 169S(3) - application of definition of "ordinary share capital" – ITA, s 989 – whether redeemable shares with no right to a dividend were shares with a right to a dividend at a fixed rate (of 0%) and thus not "ordinary share capital" – no – HMRC's appeal allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

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

- and -

(1) MICHAEL McQUILLAN
(2) ELIZABETH McQUILLAN **Respondents**

TRIBUNAL: MRS JUSTICE ROSE
JUDGE ROGER BERNER

Sitting in public at The Royal Courts of Justice, Rolls Building, Fetter Lane, London EC4 on 26 July 2017

Marika Lemos, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Appellants

Joseph Murray, of Joseph Murray Limited, Chartered Accountants and Statutory Auditors, for the Respondents

DECISION

1. This appeal by HMRC from the decision of the First-tier Tribunal (Judge Christopher Staker) released on 5 May 2016 ([2016] UKFTT 0305 (TC)), which is brought with permission of Judge Sinfield in this Tribunal, raises a short, but important, point of the statutory construction of the definition of "ordinary share capital" in s 989 of the Income Tax Act 2007 ("ITA"), in the context of its application to the meaning given to an individual's "personal company" in s 169S of the Taxation of Chargeable Gains Act 1992 ("TCGA").

The law

2. The statutory context is that of the Entrepreneurs' Relief which was introduced as Chapter 3 of Part V TCGA with effect from 6 April 2008 as part of a range of measures including the abolition of taper relief, the withdrawal of the indexation allowance (for non-corporates) and at that time a flat rate of capital gains tax of 18%. As introduced, the effect of the entrepreneurs' relief, in cases to which it applied, was to apply to chargeable gains an effective rate of 10%, subject to an original lifetime limit of £1 million.

3. The entrepreneurs' relief applies to certain qualifying business disposals, of which one is the material disposal of business assets (s 169H(2)(a) TCGA). A disposal of business assets includes a disposal of shares in a company (s 169I(2)(c)). To be a material disposal of shares, two conditions (Condition A and Condition B) must be satisfied. For the purpose of this appeal, only Condition A is relevant, and it is set out in s 169I(6):

> "Condition A is that, throughout the period of 1 year ending with the date of the disposal—
>
> (a) the company is the individual's personal company and is either a trading company or the holding company of a trading group, and
>
> (b) the individual is an officer or employee of the company or (if the company is a member of a trading group) of one or more companies which are members of the trading group."

4. It is thus a requirement that, for the relevant period prior to the disposal, the company is the individual's personal company. That term is defined by s 169S(3), as follows:

> "For the purposes of this Chapter 'personal company', in relation to an individual, means a company—
>
> (a) at least 5% of the ordinary share capital of which is held by the individual, and
>
> (b) at least 5% of the voting rights in which are exercisable by the individual by virtue of that holding."

5. A "personal company" is therefore defined by reference to a specified percentage of both ordinary share capital and voting rights. We are concerned with "ordinary share capital" which is itself defined by s 169S(5) in the following way:

> "'ordinary share capital' has the same meaning as in the Income Tax Acts (see section 989 of ITA 2007)"

6. Section 989 ITA provides for the meaning of "ordinary share capital" as follows:

> "'ordinary share capital', in relation to a company, means all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits"

Background

7. Mr and Mrs McQuillan established a business, described by Mr Murray, appearing for them, as a sandwich shop business, in 1999. In 2004, along with Mrs McQuillan's brother and sister-in-law, Mr and Mrs Pennick, and with a view to franchising the business, they set up a company, The Streat Franchising Limited ("Streat"). The original share capital of Streat consisted of 100 £1 ordinary shares of which Mr and Mrs McQuillan each held 33 and Mr and Mrs Pennick each held 17. At some point, Mr and Mrs Pennick made a loan to Streat of £30,000, shown in the company's accounts as a directors' loan.

8. The business expanded rapidly, and in early 2006 Streat approached Invest Northern Ireland ("Invest NI"), the regional business development agency, for certain grants. Invest NI offered grants to Streat, but on the pre-condition that Mr and Mrs Pennick's directors' loan be converted into shares in the company, and that there be no repayment before March 2009.

9. The FTT records, at [5] of its decision, that at a directors' meeting on 12 June 2006 it was resolved that the £30,000 loan would be converted into 30,000 redeemable ordinary shares of £1 each. The FTT does not appear to have seen any resolution of the directors or shareholders in this respect, or the articles of association, but found that an amended shareholders' agreement recited that the authorised share capital of Streat was £100,000, divided into 100,000 shares of £1 each, of which there had been issued at par and fully-paid 100 voting shares and 30,000 redeemable non-voting shares.

10. At that time, the shares in Streat were held as follows:

Shareholder	**Number of ordinary shares**	**Number of redeemable shares**
Mr McQuillan	33	
Mrs McQuillan	33	

Mr Pennick	17	15,000
Mrs Pennick	17	15,000
Total	100	30,000

11. The FTT also found that the shareholders' agreement provided with respect to the redeemable shares that: "Any Redeemable Share Capital from time to time in issue shall not bear any voting rights and will be redeemable at par at a future date decided by the Directors at their sole discretion." The agreement also provided that any dividends would be paid to the shareholders but was silent on the question of the proportion in which they would be paid. Nonetheless, on the basis of the evidence before it, which included oral evidence given by Mr and Mrs McQuillan, the FTT found, at [7], that:

> "[Mr and Mrs McQuillan] and Mr and Mrs Pennick always agreed and understood between themselves that the 30,000 redeemable shares would have no right to any dividends, and conferred no rights of ownership over the business, and that these shares represented merely an interest-free loan of £30,000 by Mr and Mrs Pennick to [Streat]. The possibility was never entertained by either Mr and Mrs Pennick or [Mr and Mrs McQuillan] that the redeemable shares would in any way feature in the sale of [Streat], and it was in accordance with their common understanding that the 30,000 redeemable shares were redeemed at face value prior to the sale of [Streat]."

12. In the autumn of 2009, a larger enterprise offered to buy Streat. In the process leading up to that sale, at a directors' meeting on 14 December 2009, the directors resolved that the 30,000 redeemable shares be redeemed with immediate effect. Following a dividend for the period ended 31 October 2009 paid on the 100 ordinary shares (the FTT does not say so in terms, but it is clear that the dividend was payable in respect of the non-redeemable ordinary shares only), on 1 January 2010 all the remaining 100 issued shares were sold to the purchaser.

13. In their self assessment returns for the tax year 2009-10, Mr and Mrs McQuillan claimed entrepreneurs' relief in respect of their disposals of their ordinary shares in Streat. That claim was refused by HMRC, on the basis that neither of Mr and Mrs McQuillan had, throughout the period of one year ending with the date of the share sale, held at least 5% of the ordinary share capital of Streat. That conclusion followed from the view of HMRC that the 30,000 redeemable shares were part of the "ordinary share capital" of Streat.

14. It was from that conclusion that Mr and Mrs McQuillan appealed to the FTT. The FTT allowed their appeal, for the reasons we shall discuss. HMRC now appeal against the FTT's decision.

The FTT's decision

15. At [24] of its decision, having made its findings of fact and recited the respective arguments of the parties, the FTT directed itself that the question for determination was whether the expression "dividend at a fixed rate" in s 989 ITA includes shares the holders of which have no right to a dividend. It took the view, at [27], that there was an element of ambiguity in the literal meaning of s 989, saying:

> "The Tribunal is not satisfied that the wording of the s 989 ITA 2007 of itself permits only one possible answer to this question. It can obviously be argued, as HMRC does, that a right to no dividend is not a right to 'a dividend', and therefore cannot be a right to 'a dividend at a fixed rate'. However, it can also be tenably argued, as the Appellant does, that a zero rate is a fixed rate, as in the case of a zero rate of VAT. Zero is a number."

16. At [31] the FTT contrasted the position of the redeemable shares in this case with an alternative structure under which those shares would have carried a fixed dividend of a purely nominal amount (the FTT postulated a *de minimis* yearly dividend of 1/15,000th of a £ per share) to demonstrate that in the latter case it would have been clear that the redeemable shares would have given the holder a right to a dividend at a fixed rate. If that had been the structure chosen, the 30,000 redeemable shares would not have fallen within the definition of "ordinary share capital" in s 989 ITA, Mr and Mrs McQuillan would have owned more than 5% of the ordinary share capital of Streat, Streat would have qualified as their personal company for the purposes of s 169S(3) and they would both have been entitled to entrepreneurs' relief. The FTT considered that it was "difficult to see why the redeemable shares in the present case should be treated any differently when the only difference is that instead of bearing a purely nominal fixed dividend, they bear a zero dividend".

17. The FTT, at [32], expressed sympathy with the position Mr and Mrs McQuillan had found themselves in, having regard to the reason for the creation of the redeemable shares, the fact that they had been intended to change nothing of substance from the previous directors' loan arrangements (save to provide for a deferral of the earliest possible date for repayment) and the change in the law from April 2008. The FTT reasoned, at [33], that where the meaning of statutory provisions is not plain, "considerations of common sense may be relevant under ordinary principles of statutory interpretation". The FTT did not attempt to apply a purposive construction, commenting only that no material had been provided by the parties as to the policy intentions behind the particular wording of the definition of "ordinary share capital" in s 989 ITA.

18. The FTT's conclusion was expressed at [34] in the following terms:

> "In short, the Tribunal finds that in relation to the question before it, there is some ambiguity in the wording of the definition of "ordinary share capital" in s 989 ITA 2007. On the very limited information before it, the Tribunal is persuaded that in the particular circumstances of the present case, a right to no dividend is a right to a dividend at a fixed rate for purposes of that definition. The Tribunal does not need to determine whether the answer would be the same in all other contexts

> or circumstances … No explanation was given to the Tribunal by HMRC as to the possible implications of the answer to this question in other contexts."

Discussion

19. The basis for the FTT's conclusion as to the meaning of s 989 ITA was its view that there was ambiguity in the literal meaning of that provision. We do not agree. In our judgment, s 989 permits of only one interpretation, and does not countenance a right to no dividend being a right to a dividend at a fixed rate.

20. Section 989 starts with the premise that "ordinary share capital", as a defined term, includes all of a company's issued share capital. There is no doubt that in this case the redeemable shares were part of Streat's issued share capital. The only exception is in respect of capital (a) the holders of which have a right to a dividend, (b) which dividend is at a fixed rate and (c) where that dividend right is exhaustive of the right to share in the company's profits.

21. It is in our view plain, on the literal meaning of s 989, that to be within that excluded class the shares in question must have a right to a dividend. Once it is determined, as a matter of fact, that the shares carried no right to a dividend, there is no question of the shares falling outside the definition of "ordinary share capital". The FTT decided on the evidence, at [7] of its decision, that the redeemable shares carried no right to a dividend. In our judgment that is enough to conclude that the redeemable shares in this case fall within that definition, and are not the kind of shares excluded from the definition. They must accordingly be counted in any calculation of Mr and Mrs McQuillan's interest in ordinary share capital for the purpose of ascertaining whether Streat was their "personal company" within the meaning of s 169S(3) TCGA and so whether they satisfied Condition A in s 169I throughout the relevant period.

22. The error into which the FTT fell is apparent from the way in which it expressed its view of the ambiguity of s 989 ITA at [27] of its decision. In taking the view that there could be a tenable argument that a zero rate could be a fixed rate, it ignored the prior requirement that there must be a right to a dividend. Even if such a construction of "fixed rate" were permissible (and for the reasons we shall give below we do not consider it is), that could not give rise to a right to a dividend; it could only give rise to a right to no dividend or, put another way, no right to a dividend at all.

23. At a late stage in his submissions, and subsequently in further post-hearing written submissions made by him at our invitation, Mr Murray was disposed to argue that it was inherent in all shares that they have a right to a dividend, and that specific shares might have what he described as "tapered rights", such as those in this case. We accept, as a matter of principle, that all shares rank equally as to capital and dividend unless the memorandum or articles of association or other terms of their issue indicate to the contrary (*Birch v Cropper* (1889) 14 App Cas 525). That, however, cannot assist in a case where there has been a finding that the shares in question have no dividend rights and accordingly there has been a clear expression of a contrary intention. For the redeemable shares to have been taken outside the

meaning of "ordinary share capital" they would have had to have a right to a dividend. The redeemable shares had no such right.

24. We reject also the post-hearing submission of Mr Murray to the effect that he had not himself asserted that the redeemable shares carried "no right to a dividend". Not only is such a submission, directed as it is to the FTT's finding of fact, far too late to be admitted for consideration, but what Mr Murray may have argued before the FTT is not material. What is material is that the FTT found as a fact on the evidence that the redeemable shares had no right to any dividends. That finding accorded with the explanation of why the shares had been created and issued to the Pennicks and was consistent with the terms of the shareholders' agreement as Mr and Mrs McQuillan described it.

25. The FTT equated its finding that the redeemable shares had no right to any dividends with the shares having a right to a fixed dividend of 0%. We do not consider that such a construction of the rights of the redeemable shares could properly have been arrived at. It cannot be properly concluded that shares which have no right to a dividend should be regarded as having a right to a divided at a fixed rate of 0% and so consequently have a right to a dividend. The analysis is circular and flawed.

26. Even if the shares had been described in the shareholders' agreement as shares with a right to a dividend at a fixed rate of 0%, they could not then properly be described as shares having a right to a dividend for this purpose. At the hearing we referred the parties to *Revenue and Customs Commissioners v Apollo Fuels Limited and another* [2016] STC 1594, where in different circumstances a similar question had been addressed by the Court of Appeal. In that case, the central issue was whether an employee was liable to income tax in respect of a car leased to him by his employer on arm's length commercial terms, including lease charges at full market value. The Court of Appeal decided that the charge to income tax arose only if the terms on which a car was leased to an employee conferred a "benefit" on the employee in the ordinary sense of that word. As there was no such benefit in that case, no tax charge arose.

27. In his judgment, David Richards LJ also considered, *obiter*, whether the effect of s 114(3) of the Income Tax (Earnings and Pensions) ACT 2003 ("ITEPA") was to prevent a charge to tax. That provision excluded the relevant taxing provisions if there was an amount constituting earnings from the employment in respect of the benefit of the car by virtue of any other provision. The Upper Tribunal (Rose J) had found that there was such an amount by reference to a nil amount of tax arising under s 62 ITEPA (which defines "earnings" in relation to an employment). Lord Justice Richards, with whom Sales LJ and Sharp LJ agreed, took a different view. He said, at [82]:

> "… Nil is not a number or an amount, but the absence of a number or an amount. It is a cipher of no value. There may, of course, be circumstances where the context in which the word 'amount' is used indicates that it is to include nil. But, the ordinary meaning of the phrase 'an amount constitutes earnings from the employment' connotes

> a positive number, in other words an amount. There is nothing, in my judgment, in the context which dictates a different approach."

Richards LJ reached a similar conclusion, at [89], in relation to the subsidiary question whether a cash equivalent of nil could "be treated as the employee's earnings" within s 236(2)(b) ITEPA. He held that it could not. If the cash equivalent was nil, it formed no part of the earnings.

28. Those remarks were of course in a different statutory context, and they were strictly *obiter*. But we would take the same view of any purported provision for a fixed rate of dividend at 0%. That, in our judgment, could not be regarded as a right to a dividend; it should properly be construed as conferring no right to a dividend.

29. We invited the parties to make further submissions regarding *Apollo Fuels* following the hearing if they wished to do so. HMRC informed the Tribunal that they had no such further submissions to make. In making his further submissions, Mr Murray sought to rely on elements of the Upper Tribunal decision in that case with which the Court of Appeal had disagreed. He argued that this demonstrated the ambiguity of the legislation. We reject those submissions. In our view, the Court of Appeal judgment does not illustrate any ambiguity; it makes a finding as to the clear and unambiguous meaning of the relevant provisions in that case. Nor, in any event, could any perceived ambiguity of any provision in *Apollo Fuels* be of any relevance to any question of statutory construction in this case.

30. Mr Murray also sought to argue that *Apollo Fuels* showed that HMRC were adopting inconsistent positions on the question whether zero, or nil, could be a number. Not only do we consider that to be an irrelevant consideration – a position argued by a party in respect of one statutory provision can be no indicator of the construction of another provision – it is in any event an incorrect reading of the cases put by the parties in *Apollo Fuels*. The argument in that case that a nil amount arising under s 62 ITEPA was nonetheless "earnings" was an argument of the employees, and not a submission by HMRC (see, per David Richards LJ, at [80]).

31. The FTT in the present case appears to have been persuaded, at least in part, that a zero rate is a fixed rate by reference to the zero rate of VAT that applies to supplies of falling within certain specified categories. That, in our judgment, was not a proper basis for the FTT to conclude that a right to a zero dividend was a right to a dividend at a fixed rate. As the ECJ has accepted, in *EC Commission v United Kingdom* (Case 416/85) [1988] STC 456, at [10], the UK's domestic system of zero-rating is essentially equivalent to the exemption with refund which is now provided for by Article 110 of the Principal VAT Directive (Council Directive 2006/112/EC). Although therefore zero-rated supplies are taxable supplies under domestic law, that is, as the Advocate-General (Kokott) remarked in *Marks & Spencer plc v Revenue and Customs Commissioners* (Case C-309/06) [2008] STC 1408, in a notional sense only. Zero-rating is not therefore properly described as a rate of tax at all; it is the mechanism adopted by the UK to reflect the exemption with refund system permitted by way of derogation under the transitional measure contained in Article 110. It cannot assist any analysis of the nature of a right, if one can be discerned, to a dividend at a rate of 0%.

Purposive construction

32. The FTT confined itself to a literal interpretation of s 989, adopting a construction which it considered was open to it on the basis of ambiguity. For the reasons we have explained, we consider that the FTT erred in law in doing so. But both before the FTT and before us, Mr Murray submitted that to deny entrepreneurs' relief in the circumstances of the disposals by Mr and Mrs McQuillan would be inconsistent with the spirit and intention of the legislation, and we need therefore to consider whether a purposive construction of s 989 ITA, in the context of the provisions of Chapter 3 of Part V TCGA applying to entrepreneurs' relief, can result in the relevant conditions being satisfied.

33. We are satisfied that no process of purposive construction can have that effect. First, it is important to recognise that the "purpose" here must be the purpose of s 989 not the purpose of the entrepreneurs' relief provisions in the TCGA. We do not agree with the assumption implicit in [34] of the FTT's decision that s 989 ITA might bear a different meaning when it is imported by cross-reference into provisions relating to a particular tax regime from the meaning it bears in the statute of which the definition section forms a part. If Parliament had wished to enact a bespoke meaning of "ordinary share capital" when defining an individual's "personal company" in s 169S(3) TCGA it could have done so. Thus, in some cases where ordinary share capital has been employed as the means of establishing a particular relationship, that has led to the legislature augmenting the provisions to introduce further tests more aligned to the economic result. Ms Lemos, appearing for HMRC, referred us to one example, namely the introduction of additional requirements, running alongside the basic ordinary share capital test, for companies to be 75% and 90% subsidiaries (see s 151 of the Corporation Tax Act 2010 ("CTA")) for the purpose of group and consortium relief. Nothing so sophisticated applies to the entrepreneurs' relief, because Parliament chose to import a definition which, as Ms Lemos showed us, is used in many different statutory contexts relating to tax law. Although counsel for HMRC before the FTT may not have had a ready answer to the FTT's query about the wider effect impact of the construction of s 989 argued for by the McQuillans, the tribunal must take into account the risk that the repercussions of its construction of s 989 could be unexpected and far reaching.

34. In our judgment, the purpose of s 989 ITA is readily apparent from the statutory language itself. It is a provision of definition which is intended to describe a clear, and readily understandable, description of the shares to which it applies. It is imported into s 169S(3) TCGA to establish a bright dividing line between those shares which will be reckoned with in assessing the extent of an individual's interest in a company for the applicable period prior to the disposal of shares or securities in a company, and shares which are not. A dividing line will have the necessary, and inevitable, consequence that some cases which are similar in economic terms will fall on one side of the line and others will fall on the other side. That, as the Upper Tribunal (Asplin J and Judge Berner) said in *Revenue and Customs Commissioners v Trigg* [2016] STC 1310, at [57], is nothing more than a normal incident of the drafting of statutory conditions defining a particular statutory concept (in this case that of "ordinary share capital"). As the Upper Tribunal in *Trigg* went on to say:

> "It is not for the tribunal to fill any perceived gap, or to seek to equate cases on one side of the dividing line with similar cases falling on the other side by reason of similarity in effect or economic equivalence. Purposive construction cannot go so far. To construe such legislative conditions in that way would risk undermining rather than applying the distinction determined upon by Parliament according to the plain words of the legislation."

35. The language of s 989 is, as we have found, unambiguous. The intention is equally clear and unambiguous from the language that Parliament has adopted. There is in our view no possible recourse in this case to the spirit of the legislation. As the Upper Tribunal said in *Trigg*, at [35]:

> "There is also, in our judgment, a distinction between the policy behind, or the reason for, the inclusion of a particular provision in the legislative scheme and the purpose of that provision. Parliament might wish to achieve a particular result as a general matter, and legislate for that reason or in pursuit of that policy. But if the statutory language adopted by Parliament displays a narrower, or more focused, purpose than the more general underlying policy or reason, it is no part of an exercise in purposive construction to give effect to a perceived wider outcome than can properly be borne by the statutory language."

36. The observations of the Upper Tribunal in *Trigg* were considered and applied by that Tribunal (Mann J and Judge Brannan) in *Flix Innovations Limited v Revenue and Customs Commissioners* [2016] STC 2206. That case concerned enterprise investment scheme (EIS) relief for which one of the conditions, in s 173(2)(aa) ITA, was that the relevant shares had to be ordinary shares which did not, in the relevant period, "carry … any present or future preferential right to a company's assets on its winding up". It was accepted that the effect of there being deferred shares in the company's share capital (which had arisen due to a reorganisation entirely for commercial reasons) was that the ordinary shares had a preferential right on a winding-up to the extent of the nominal value of those ordinary shares.

37. It was argued for Flix that the purpose of Parliament, reflected in s 173 ITA, was to restrict EIS relief to ordinary shares that were genuine shares, in other words shares which carried the economic risk and reward of ownership. The ordinary shares in Flix were, it was submitted, such shares. The preferential right of those ordinary shares to assets on the winding up was so minimal, the argument went, that when interpreted from a commercial standpoint it was correct to ignore it.

38. That argument was rejected by the Upper Tribunal. At [42], in a passage to which we drew the parties' attention at the hearing, the tribunal said:

> "Although we are minded to accept the general policy of the EIS legislation was, as Mr Howard submitted, to limit relief to ordinary shares which carried the risk and reward of ownership, Parliament implemented this policy by limiting relief, *inter alia*, to those ordinary shares which did not carry any present or future preferential rights to assets on a winding up. 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 return of capital existed. As this tribunal said at [35] in *Trigg*, purposive construction cannot be used to give effect to a perceived wider policy in cases where the words used will not bear that meaning."

39. The arguments of Mr Murray in this case are in a similar vein to those in *Flix*. They fall to be rejected for the same reasons. The definition of "ordinary share capital" in s 989 ITA is not susceptible to analysis by reference to economic risk and reward. Nor can the accounting treatment of the particular shares be relevant to the construction of that term. Mr Murray submitted that the 2008 financial statements for Streat (which we did not have before us) noted that the redeemable shares had been classified as financial liabilities under FRS 25. However, the classification of shares as debt, as opposed to equity, in the accounts does not detract from the fact that the redeemable shares were shares and that they were part of the issued share capital of Streat. Section 989 draws no distinction between such shares on the basis of their accounting treatment, and no such distinction can be imported by way of statutory construction.

40. We should note for completeness that, having ourselves drawn *Flix* to the attention of the parties, we invited them to make further post-hearing submissions in that respect if they were minded to do so. Neither party chose to make any such submissions.

41. In her submissions to us at the hearing, Ms Lemos referred us to the decision of the First-tier Tribunal (Judge Cornwell-Kelly and Mr Menzies-Conacher) in *Castledine v Revenue and Customs Commissioners* [2016] SFTD 484, where the question of the construction of s 989 ITA was addressed in the same context of the entrepreneurs' relief as in this case. The issue in that case concerned whether certain deferred shares were "ordinary share capital"; if they were not then Mr Castledine would have held 5% of the ordinary share capital and be able to claim the relief, but if they were then that percentage would reduce to 4.99%, and he would not be entitled to the relief. The deferred shares in question had been introduced for commercial reasons, namely to provide a mechanism for certain B ordinary shares to be converted into deferred shares in certain events, including when an employee holder left the company; the deferred shares were automatically transferred to an employee benefit trust for a nominal consideration.

42. The tribunal held that the deferred shares were part of the "ordinary share capital" of the company. As part of the Mr Castledine's arguments, it was submitted that the deferred shares were shares only in name, and that it was the ordinary shares as such in the company which carried entrepreneurial risk. It was argued that if the deferred shares were classified as "ordinary share capital", the obvious intention of Parliament would be defeated by a technicality. The tribunal was not persuaded by those arguments. It accepted HMRC's case that the only intention which could properly be attributed to Parliament was an intention to establish a dividing line for the relief, that the nature of dividing lines was that they had to be clear and predictable and, necessarily, they would create hard cases close to the line. It was conscious of the need to avoid judicial legislation, referring in that respect to what

Lord Nicholls had said in *Pollen Estate Trustee Co Ltd v Revenue and Customs Commissioners* [2013] STC 1479, at [25]. In those circumstances, the tribunal concluded that it was not able to depart from the plain meaning of the legislation.

43. The decision in *Castledine* is thus consistent with our own. There is in this case no purposive construction that can prevent the redeemable shares from being part of the "ordinary share capital" of Streat, as that expression is defined by s 989 ITA, for the purpose of the definition of "personal company" in s 169S(3) TCGA. On the facts of this case, the consequence is that Streat is not the "personal company" of either of Mr and Mrs McQuillan and entrepreneurs' relief does not apply to their disposals of shares in that company on 1 January 2010.

44. Like the FTT, we sympathise with the circumstances in which Mr and Mrs McQuillan have found themselves. We recognise that they are the kind of entrepreneurs for whom the relief was devised. They saw an opportunity to develop a business in a particular market and they devoted their time, energy and resources to building up a successful company with all the risks and rewards that that involves. The statistics Mr Murray cited to us at the hearing about the rapid growth of the business in terms of outlets, employees and turnover are undoubtedly impressive. They are understandably aggrieved that they should be denied relief in circumstances where, through a commercial requirement of a grant-provider, a loan to Streat was converted into shares with no change in the economic substance and which remained a financial liability for accounting purposes, where they say they would have been entitled to taper relief under the law as it then stood, and where after the shares had been issued there had been a change in the law so as to deny them relief.

45. A definition such as that in s 989 ITA is apt to produce results which appear unfair. There will be deserving cases that fail to qualify for relief, and non-deserving ones that do qualify. Such a definition may enable those who are well-advised to fall within its terms, whilst leaving a trap for the unwary. There is certainly a case for the legislation to be reviewed to address what may understandably be perceived as unfairness in particular cases, of which this is one. That will, however, be a matter for Parliament if it determines that such a change should be made.

Decision

46. For the reasons we have given, we allow the appeal of HMRC, and we set aside the decision of the FTT.

MRS JUSTICE ROSE
UPPER TRIBUNAL JUDGE ROGER BERNER

RELEASE DATE: 6 September 2017