



**TC03045**

**Appeal number: TC/2012/11171**

*CGT – EIS – proceeds of share subscription invested in partnership of which company already a member and paid out to other partners – whether monies raised for the purpose of, or employed in a qualifying business activity – para 1(2)(f) and (g) Sch 5B TCGA 1992. Held: no.*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**HARVEY'S JERSEY CREAM LIMITED**

**Appellant**

**- and -**

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

**Respondents**

**TRIBUNAL: JUDGE CHARLES HELLIER  
WILLIAM HAARER**

**Sitting in public in Plymouth on 2 October 2013**

**Roger Bibby, tax consultant, instructed by Condy Mathias for the Appellant**

**Simon Foxwell for the Respondents**

## DECISION

1. The Enterprise Investment Scheme (EIS) provisions in Schedule 5B Taxation of Chargeable Gains Act 1992 ("TCGA") provide that where the conditions of the schedule are satisfied the amount paid to subscribe for shares in a qualifying company may be set against capital gains made by the investor. This legislation has a non-identical twin in chapter III Part VII of the Taxes Act 1988 (which is re-enacted in Chapter 3 Part 5 ITA 2007). The words which arise for consideration in this appeal appear in almost identical form in TA 1988.

2. The provisions at issue in this appeal are in subparagraphs 1(2)(f) and (g) of Schedule 5B. Stripped to their essentials for the purpose of this appeal they set out two conditions for the relief:

"(f) the shares...are issued in order to raise money for the purpose of a qualifying business activity; and

"(g) all the money raised by the issue of shares is employed wholly for the purposes of that activity" within a set period.

3. By paragraph 19 of Schedule 5B a "qualifying business activity" is given the meaning in section 289 (2) TMA 1988 which provides:

"(2) In this Chapter "qualifying business activity", in relation to a company means -

(a) the company or any qualifying 90% subsidiary of that company --

(i) carrying on a qualifying trade which, on the date the shares are issued, the company or any such subsidiary is carrying on, or

(ii) preparing to carry on, or carrying on, a qualifying trade which, on that date is intended to be carried on wholly or mainly in the United Kingdom by the company or any such subsidiary and which is begun to be carried on by the company or any subsidiary within two years after that date,

but only if, at any time in the relevant period when the qualifying trade is so carried on it is carried on wholly or mainly in the United Kingdom, or

(b) ..."

A "qualifying trade" is a trade other than one of particular descriptions.

4. Put broadly, the issue which arises on the facts of this appeal is whether the combined effect of these provisions is that share subscription monies must be intended to be, and must be, employed either:

(1) in the trade, or

(2) in relation to the trade.

5. In this appeal the Appellant company was a partner in a trading partnership; it raised money by the issue of shares and increased its interest in the partnership, the monies effectively being paid out to the other partners. The question is whether the

acquisition thereby of any increase in its interest in the partnership was a qualifying business activity.

**The evidence and the facts.**

5 6. We had before us a bundle of copy correspondence and documents. We heard no oral evidence but some limited additional factual information was provided to us by Mr Bibby.

10 7. Shortly after its incorporation in June 2001 the appellant company became a partner in the business of L & R Harvey and Partners. The other partners were Mr L Harvey and his three adult children: James, and David and Wendy. The share capital of the company was owned by those four partners. The partnership business was the manufacture and delivery of ice cream and dairy products, and included the running of the dairy herd, on land owned or occupied by the partnership, which produced some of the milk for the ice cream and dairy products.

8. In or around 26 November 2003:

15 (1) each partner took drawings from the partnership;

(2) each partner subscribed for shares in the company in amounts corresponding to those drawings (we were not told whether they were precisely the same or not);

20 (3) the company paid the total amount raised by the share issue, some £1.25 million, to the partnership.

9. There was some uncertainty as to the precise order of these events, but they were planned and executed as a composite whole.

25 10. On 28 November 2003 the partners executed a Third Supplemental Partnership Deed which set out inter alia the intended effects of (3) above. The contents of this deed are described below.

11. The process of withdrawal, subscription, and payment to the partnership was repeated on 27 July 2004. The amount involved on this occasion was in total some £750,000. We were not shown any further Deed executed following that subscription but we understand that the effect of the second tranche followed that of the first.

30 12. The company applied to HMRC under section 306(4) TA 88 for authority to issue EIS certificates in respect of the shares it had issued in these transactions. HMRC refused to give that authority. This appeal is against that refusal.

35 **The parties' arguments.**

13. In earlier correspondence with the Appellant HMRC had raised a number of objections to the company's application for authorisation. Apart from the issue debated in this appeal those concerns had been resolved in the company's favour and

were not before us. In particular HMRC accepted that the business of the partnership was a qualifying trade for the purposes of section 297 TA88, and that the amounts paid had been at arms length. Mr Foxwell also indicated that HMRC did not intend to pursue any argument in relation to the anti-avoidance provisions of paragraph 1(2)(d) Schedule 5B.

14. Mr Bibby says that properly construed subparagraphs (f) and (g) do not require the money raised to be used in the trade - it is enough if they are used to acquire a greater interest in the trade. In particular he says

- (1) that the focus of these provisions is on the company and what it does;
- 10 (2) in this case the company acquired a greater interest in assets used in the trade: that was the employment of monies for the purposes of the trade and in the qualifying activity;
- (3) the provisions do not require any value to be added to the trade;
- (4) the assets were fundamental to the profit-making apparatus of the trade;
- 15 (5) use for the purpose of a qualifying business activity included use for the purpose of anything done in relation to the trade

15. Mr Foxwell says that :

- (1) the money raised by the company was used in effect to purchase an increased share in the partnership from the other partners. That was not employment in the activity or use for the purposes of the activity;
- 20 (2) the money went round in a circle: it came from the partnership to the partners and then went back to the partners. The monies were not employed in the trade but employed in financing payments to the partners;
- (3) the qualifying business activity was the trade. That trade was conducted by the partnership; not separately by the company. In order to satisfy the conditions in para 1(2) the monies had to be intended for and employed in the trade. They were not. There was no benefit or added value to the trade;
- 25 (4) the focus of the provisions was on the trade not the company. It was not possible to view the qualifying business activity as being the activity of having an interest in the partnership; and
- 30 (5) in ascertaining the "purpose" of the share issue the question is what was the subjective purpose of the directing minds of the company. The directing minds were its directors who are the same people as the partners. That purpose thus must have encompassed the return of the funds subscribed by them. No evidence had been provided of any other purpose. The best that could be assumed was that what the partners wanted was a change in the relative shares of the persons owning the trade.
- 35

16. In reply Mr Bibby says that it is over simplistic to regard the money as going round in a circle. These were real transactions which had enduring consequences.

40 17. Mr Bibby also points to HMRC's published materials of the time which accepted that shares subscribed by the owner of a business so that the issuing company

could purchase that business could qualify for EIS purposes. This was conceptually the same as what happened here.

**Discussion.**

18. We start by considering the effect of the Deed.

5 *The Third Supplemental Deed.*

19. We were not shown a copy of the partnership deed but the Third Supplemental Deed was expressed to be supplemental to it. We also had copies of the partnership's accounts for the years from 2003 to 2006.

20. The Deed contains the following provisions:

10 "Whereas:...

D. The partners now wish to vary their respective interests in the partnership to those shown in Schedule 2 [which showed the partners' interests in capital assets of the partnership and the interest of the company in such assets increasing from 5% to 60%] and to introduce as Partnership Assets in the same proportion the non-partnership assets shown in Part B of Schedule 1.

[Part B of that Schedule related to interests in land which had previously been held by the four individual partners otherwise than as partnership assets. Schedule 2 showed that after the execution of the deed the partners' interests in that land, as a partnership asset, would be in the same proportions as in relation to other major capital partnership assets.]

E. The partners also wish to vary their fixed capital account balances from those shown in the second column of Schedule 3 to those shown in the third column of Schedule 3.[This showed an increase in the company's capital from 20% to 60% of the total.]

25 ...

"Now it is hereby agreed as follows:

1. In consideration of the net payment by the Company and the net receipts by [the other partners as set out in the schedule] the Partners' interests in capital assets shall henceforth be in the proportions set out in Part A of Schedule 2 [that schedule shows the interest of the company in major capital partnership assets increasing from 5% to 60% with corresponding reductions in the interests of the other partners].

... 5. On 28 November 2003 the Company has paid into the partnership bank account the sum of £1,190,000 and such sum shall be apportioned and credited as to £185,000 to the account Mr Harvey and £335,000 as to each of the accounts of James, David, and Wendy on account of the net payment and net receipts recorded at part B of Schedule 2.

21. The deed also contained provisions for adjustment payments once values of the major capital assets had been agreed with the district valuer.

40 22. The partnership's accounts for the years 2003 to 2006 show a sharing of income profits and losses between the partners in proportions which vary from year to year.

We were told by Mr Bibby that each year's division of profits was fixed after the year end by agreement between the partners.

23. Section 24 of the Partnership Acts 1890 provides:

5 "The interests of partners in the partnership property and their rights and duties in relation to the partnership shall be determined, subject to any express or implied agreement between the parties partners, by the following rules:

(1) All the partners are entitled to share equally in the capital and profits of the business, and must contribute equally towards the losses whether of capital or otherwise sustained by the firm."

10 24. We conclude that in those years the partners had agreed to share *income* profits otherwise than equally and that each partner was entitled to such share of the income profits and losses of the partnership for any year as the partners might agree following the end of that year, and in default of such agreement to share equally.

15 25. There was nothing in the Deed, the accounts or in Mr Bibby's submissions which suggested that the partners' rights to share in income profits were different as a result the execution of the Deed. We concluded that the Deed did not alter the partners' rights to share in income profits and losses.

20 26. There is a difference between assets held by one or more partners which are used by the partnership, and assets held the partners as partnership property. The use of the latter is constrained by the partnership agreement and are part of the fund initially available to satisfy the partnership's creditors; an individual partner's own assets are available on a claims made against him both as a partner and individually. Partnership assets are held for the partnership business and partners do not have specific interests in individual assets: instead they have a form of chose in action  
25 which may be crystallised on the sale of the asset or dissolution of the partnership.

30 27. Dealing as it does with the introduction to the partnership as partnership assets of assets which were previously held jointly by only some of the partners, in our view the Deed makes it clear that the capital assets of the partnership (as set out in the schedule), are intended to be partnership assets and not assets held by the partners as individuals and used for the purposes of the partnership. As a result the partners did not have specific interests in them.

35 28. But the specification of a specific share in an asset carries with it in our judgment a setting aside of the normal presumption of equal sharing of profits and losses between partners so that the shares of *capital* profits and losses on these assets would be in the shares set out. Thus, in our opinion, the effect of the deed was not to increase the company's interest in any partnership asset, but to increase the interest of the company in the capital profits and losses which might be derived from the disposal of those assets.

40 29. In other words the effect of these provisions was not to give the company a specific interest in specific assets which were used by the partnership, but increase the rights of the company in relation to the capital profits of the partnership.

30. Thus the changes in the company's interests which followed the payment of cash to the partnership's bank account and the execution of the Deed were:

- (1) that there was no effect on its right to share in income profit.
- 5 (2) that on a sale of any of the capital assets of the partnership the company's share in any capital profit or loss arising would be greater; and
- (3) that, by reason of the increased amount of its current and capital accounts, its return on a dissolution of the partnership would be greater.

*The legislation*

10 31. Because of the form of the definition of in section 289(2) it is difficult simply to substitute for "qualifying business activity" in subparagraphs (f) and (g), the definition in section 289(2). The following (excising references to 90% subsidiaries) is the nearest rendition of the composite:

- (f) the shares are issued in order to raise money for the purpose of a carrying on by the company of a qualifying trade.
- 15 (g) all of the money raised by the issued shares is employed wholly for the purpose of the activity which is carried on by the company carrying on a qualifying trade.

20 32. The difficulty in this appeal lies in the rather unusual drafting of the definition of "qualifying business activity" in section 289(2). Rather than saying that a qualifying business activity is the carrying on of a qualifying trade it says that it is "the company carrying on" such a trade. That gives rise to the argument that, where trade is carried on by the company in partnership, there is room for the company's activities in relation to the partnership and its interest in it to be a qualifying business activity because they are encompassed within the phrase "a carrying on by the  
25 company of a trade".

30 33. But it seems to us that the tortuous drafting in section 289 arises from the inclusion of the trades of 90% subsidiaries so as to permit the trade of a 90% subsidiary carried on by the subsidiary or by the company to qualify as a qualifying business activity for the purpose of the company's share issue. It is for that reason the provision refers not simply to the carrying on of the trade but to the *company* carrying on the trade, for it has also to allow the trade to be carried on by the 90% subsidiary. It seems to us that the section otherwise evinces no intention to confer on "the company carrying on a trade" a wider meaning than "carrying on a trade".

34. The drafting is somewhat clarified in ITA 2007 section 179 of which provides:

- 35 "(1) In this Part, "qualifying business activity", in relation to the issuing company, means --
  - (a) activity A, or
  - (b) activity Bif it is carried out by the company ...
- 40 "(2) Activity A is --
  - (c) the carrying on of a qualifying trade ... or

(d) the activity of preparing or preparing to carry on ... a qualifying trade...”

35. We do not take the new provisions as affecting the interpretation of the old ones, but it seems to us that the new provisions accurately reflect the meaning of the old legislation, and that the "activities" encompassed in “qualifying business activities” mean simply the activities of the trade and nothing else. That is because the words "carrying on" appear to us to look to the activities of the trade not to other actions of the company in relation to those activities.

36. In that context we note that the second half of section 289 deals with a company preparing to carry on qualifying activities. The contrast between "preparing" and “carrying on" points to “carrying on” being the conduct of the trade itself rather than actions in relation to the trade.

37. As a result we see no difference between the activity of the company carrying on the trade and the activity carrying on of the trade.

38. We accept that other subparagraphs of paragraph 1(2) focus on the shares and the company issuing them. But that to our mind does not colour subparagraphs (f) and (g). They are freestanding conditions.

39. We accept that the provisions do not require there to be any adding of value to the trade; but that is different from requiring use in the activities of the trade. Generally use in the activities of the trade may add value to the trade: the addition of value to the trade may indicate use in the activities of the trade, but we can imagine ventures where the use of the money in a disastrous venture added no value at all to the business or even reduced its value.

40. As a result we conclude that the conditions in (f) and (g) require that the purpose of the share issue must be to raise money for the activities of the trade, and that the monies must be employed in those activities.

41. The trade of a partnership is carried on by each partner as agent for the others (see section 5 Partnership Act 1890). Thus the carrying on of the trade of the partnership was the carrying on of that trade by the company. If the monies were used in the activities of that trade they were so used by the company.

42. But, in our judgment, it is not enough that the payment conferred on the company any increased interest in the trade (by way of a greater interest in capital profits of the trade or return on dissolution or retirement or otherwise); what is required is that there be use of the money in the activities of the trade: getting a bigger share of the trade is not an activity of the trade.

43. In this appeal the monies raised were not employed in the activities of it the qualifying trade: paragraph 1(2)(g) was not satisfied. There was no evidence that they were used for anything other than to pay for changing the partners’ interests in the partnership. It would have been different if the monies had been used to pay off an overdraft incurred many years ago when a partner had withdrawn funding, or if the monies were used to buy new assets whose later sale happened to finance the later retirement of a partner: in those cases there could have been use of the money in the activities of the trade.

44. Nor can we conclude that the purpose of the share issue was to raise money for the purposes of carrying on a qualifying business activity because there was no evidence that the monies were raised with the intention that the money would be employed in the activities of the trade (and indeed the Deed suggested that the purpose was for the adjustments to the partners' accounts which would permit the payments to compensate for payments already made). All the evidence showed that the monies were intended to be employed in giving the money to the other partners. That must have been the purpose of the company. Paragraph 1(2)(f) was not satisfied.

### **Conclusion**

45. As a result we dismiss the appeal.

### **Right of Appeal**

46. 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.

**CHARLES HELLIER**  
**TRIBUNAL JUDGE**

**RELEASE DATE: 14 November 2013**