



TC04541

Appeal number: TC/2014/00168

Corporation tax – small and medium enterprises – enhanced research and development relief at 75% – SME – s 1119 CTA 2009 – Commission Recommendation EC 2003/361 - state aid – interpreted strictly – partner enterprise - meaning of institutional investor – whether must be investing on pooled basis - meaning of venture capital company – Held – Institutional investor not limited to pooled investment vehicles – investment bank and its subsidiary are institutional investors – insufficient evidence to conclude whether subsidiary venture capital company – appeal allowed.

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

MONITOR AUDIO LIMITED

Appellant

- and -

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

Respondents

TRIBUNAL: JUDGE Rachel Short

Sitting in public at Royal Courts of Justice, the Strand London on 9 March 2015

Ms Anne Fairpo of Thirteen Old Square Chambers instructed by Moore Blatch LLP for the Appellant

Mr Nicholas Saunders of Brick Court Chambers, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. This appeal concerns the availability of research and development tax deductions to the Appellant, Monitor Audio Limited (“Monitor Audio”) at the rate of 75% available to small and medium-sized enterprises under s 1044 Corporation Tax Act 2009 for the periods ended 30 September 2010 and 30 September 2011 amounting respectively to £430,097 and £755,284.

2. HMRC argue that the relief is not allowed because one of the shareholders in Monitor Audio is a partner enterprise which is neither an institutional investor nor a venture capital company and so Monitor Audio cannot be treated as a qualifying for the relief as a small or medium-sized enterprise.

Background Facts

3. There is no dispute as to the relevant facts between the parties.

4. The Appellant, Monitor Audio, is a UK resident limited company and has as its business the design and distribution of loudspeakers.

5. 43.75% of the ordinary shares and 26.22% of the voting rights of Monitor Audio were, at the relevant time, held by West Register (Investments) Limited (“West Register”) which was at the relevant time a 100% subsidiary of Royal Bank of Scotland (“RBS”).

6. That shareholding arose as a result of a management buy-out; in 2007, the Appellant bought the entire issued share capital of Monitor Audio Holdings Limited (“MAHL”) from its existing shareholders. The businesses of MAHL and another subsidiary were transferred to the Appellant, and the subsidiaries were subsequently dissolved. The Appellant paid £17.5m for this transaction.

7. The management buy-out was funded through a number of different routes. The Appellant obtained £8.7m in secured credit facilities from RBS, and £2.6m in equity from Total Capital Finance Limited (“Total Capital”), a company within the RBS group.

8. In 2008, the Appellant ran into financial trouble as a result of the recession. It could no longer finance its debts, and so began negotiating with RBS to solve this problem. In December 2008, RBS instructed BDO Stoy Hayward to conduct a review of the Appellant’s position. BDO considered both placing the company into liquidation and a “debt for equity swap”.

9. On 7th August 2009, a debt for equity swap was agreed between the Appellant and RBS. RBS converted £10.7m of its outstanding debt into shares in the Appellant. The Appellant also retained a 5 year loan of £5.5m with RBS. The vendors from the management buy-out also swapped their loan notes for different classes of equity.

10. On 17th August 2009, RBS transferred its shareholding in the Appellant to West Register. On the same day, Total Capital also transferred its shareholding to West Register. The result of this was that West Register now held (and continues to hold) 43.75% of the shares in the Appellant and 26.22% of voting rights.
- 5 11. Under Clause 12 of the Subscription and Shareholders' Agreement signed on 7 August 2009, West Register is entitled to appoint a non-executive director of the Appellant as Investor Director. The Investor Director's consent is required for any variations to share capital, and all lending, borrowing, acquisitions and disposals over a certain threshold, amongst other things. He is also entitled to disclose
10 certain information to RBS.
12. The Appellant's corporation tax computation for the accounting period ending 30th September 2010 included a claim for an additional 75% deduction for research and development expenditure, which amounted to £430,097. It noted RBS's shareholding in the company, but suggested that it was an 'institutional investor' under the EU Recommendation 2003/361. A similar deduction was
15 claimed in the tax computation for the following year, this time amounting to £755,284.
13. HMRC opened enquiries into the returns for those years on 2nd February 2012 and 11th December 2012 respectively. On 25th March 2013, HMRC issued
20 closure notices determining that the Appellant was not entitled to the relief it claimed. A statutory review rejected the Appellant's contentions in a decision of 18th December 2013. The Appellant filed a notice of appeal dated 6 January 2014. This was subsequently amended to introduce an alternative ground that West Register was a venture capital company.

25 *Law:*

UK Legislation

14 Section 1044 Corporation Tax Act 2009 ("CTA 2009") sets out the basis on which additional deductions for qualifying research and development are available in calculating the profits of a company's trade, which includes fulfilling four
30 conditions, the first being as set out under s 1044(2) CTA 2009, Condition A that the company is a "*small or medium-sized enterprise in the period*". The issue in the appeal is whether Monitor Audio fulfils that definition of a small or medium-sized enterprise ("an SME").

15 An SME is defined at s 1119(1) CTA 2009 as a "micro, small or medium-sized
35 enterprise as defined in Commission Recommendation (EC) No 2003/361, but subject to the qualifications at section 1120" (those qualifications are not relevant for this appeal).

European Legislation and Guidance.

16 The relevant European definition to which s 1119(1) CTA 2009 refers is
40 Commission Recommendation (EC) No 2003/361 (the "Recommendation"). As a

Recommendation there is no obligation on Member States to comply with its terms, but the UK has chosen to adopt it.

17 This Recommendation provides a definition of an SME, at Annex Articles 2 and
3 but also the context in which favourable treatment to small and medium-sized
5 enterprises is given including in particular an exemption from the application of
the EU State Aid rules. The Recommendation provides in its recitals a substance
as well as a form test for what amounts to an SME, stating that consideration
needs to be given to “*the real economic position of SMEs*” so that entities whose
economic power is greater than a genuine SME are excluded from the favourable
10 treatment provided.

18 The Recommendation includes detailed rules for determining what entities can
be treated as SMEs including:

a. Article 2 - Enterprises employing less than 250 persons with an annual
turnover of less than 50 million Euros and/or a balance sheet not exceeding
15 43 million Euros.

As a stand-alone entity Monitor Audio would fulfil these criteria.

b. Article 6 – sets out how the Article 2 conditions are to be calculated; in
particular that the data of any “*partner enterprise*” situated immediately
upstream or downstream from the SME are to be included in the
20 calculations.

c. Article 3 – provides a definition of a *partner enterprise* for these purposes
including an upstream enterprise which holds more than 25% or more of
the capital or voting rights of another enterprise. However an entity will
not be treated as a *partner enterprise* even if the 25% hurdle is met if it is a
25 “*public investment corporation, venture capital company..... or an
institutional investor, including a regional development fund*”.

It is the meaning of an *institutional investor* and a *venture capital company*
which are the core of this appeal.

West Register will be treated as a partner enterprise of Monitor Audio unless it
30 can be treated as an institutional investor or a venture capital company.

d. Article 3(2) states:

2. ‘*Partner enterprises*’ are all enterprises which are not classified as
linked enterprises within the meaning of paragraph 3 and between which
there is the following relationship: an enterprise (*upstream enterprise*)
35 holds, either solely or jointly with one or more linked enterprises within
the meaning of paragraph 3, 25 % or more of the capital or voting rights
of another enterprise (*downstream enterprise*).

However, an enterprise may be ranked as autonomous, and thus as not having
any partner enterprises, even if this 25 % threshold is reached or exceeded by
40 the following investors, provided that those investors are not linked, within the

meaning of paragraph 3, either individually or jointly to the enterprise in question:

5 (a) public investment corporations, venture capital companies, individuals or groups of individuals with a regular venture capital investment activity who invest equity capital in unquoted businesses ('business angels'), provided the total investment of those business angels in the same enterprise is less than EUR 1 250 000;

(b) universities or non-profit research centres;

(c) institutional investors, including regional development funds;

10 (d) autonomous local authorities with an annual budget of less than EUR 10 million and fewer than 5 000 inhabitants.

e. The meaning of a "linked enterprise" is defined at Article 3(3) as enterprises having any of four specific relationships with each other including (Article 3(3)(d) "an enterprise which is a shareholder in or member of another enterprise, controls alone, pursuant to an agreement with other shareholders in or members of that enterprise, a majority of shareholders' or members' voting rights in that enterprise")

RBS is a linked enterprise of West Register for these purposes.

20 19 In addition to the Recommendations the EU Commission published in 2005 "The new SME definition Users guide and model declaration" ("the Guide"). That includes as a note on page 18 this comment on "institutional investors":

25 a. "The European Commission does not formally define the concept of "institutional investors. They are usually seen as investors, which trade large volumes of securities on behalf of a great number of individual small investors and which have no direct involvement in the management of the firms they invest in. Mutual funds or pension funds, for instance, may be considered as institutional investors".

20 The Guide does not provide a definition of "Venture Capital Company".

30 21 We were also referred to a number of case authorities:

a. *Italian Republic v Commission* [2004] ECR – I-04355

b. *HaTeFo GmbH v Finanzamt Haldensleben* Case C-110/13

c. *Western Ferries (Clyde) Ltd v Revenue & Customs Commissioners* [2011] UKFTT 243 (TC).

35 d. *Pyreos Ltd v Commissioners for Her Majesty's Revenue & Customs* [2015] UKFTT 0123 (TC).

Points in issue

- 22 Monitor Audio will cease to be treated as an SME eligible for the 75% research
and development allowance if an upstream partner enterprise such as West
Register holds more than 25% of its capital or voting rights, unless West Register
can be treated either as an “institutional investor” or a “venture capital company”
5 within the exceptions set out in Article 3(2)(a) or (c) of the SME
Recommendation.
- 23 There is no suggestion that West Register and Monitor Audio are linked
enterprises, but it is accepted by the parties that West Register and RBS are linked
enterprises for the purposes of Article 3(2).
- 10 24 If West Register is a partner enterprise of Monitor Audio then Monitor Audio
will have to include both West Register and RBS’ balance sheet and employees in
applying the tests for an SME at Article 2 and will manifestly fail those tests.

Documents Seen

- 25 We were referred to a number of documents including:
- 15 (1) Agreement for the Acquisition of entire issued share capital of Monitor
Audio Holdings Limited dated 6 March 2007 and related financing documents.
- (2) Memorandum and Articles of Association of Monitor Audio of 2009,
including;
- 20 (a) Article 20 – Giving the Lead Investor (West Register) the right to
appoint an Investor Director.
- (b) Article 20.7 – Setting out the Investor Director’s exclusive rights to
make decisions relating to the rights arising from the purchase of the
MAHL shares in 2007.
- (3) Monitor Audio financial statements for the years ended September 2010
25 and 2011.
- (4) Subscription and Shareholders Agreement relating to Monitor Audio
dated 7 August 2009 including
- (a) Clause 7.11 Consent Matters
- (b) Clause 12 the Investors right to appoint one person as a non
30 executive director of the company - the Investor Director.
- (c) Schedule 9 the Investor Director Consent Matters – extending to 39
separate provisions in respect of which the Investor Director is required to
give his consent, covering the issuing of share capital, the entry into
certain contracts, the terms on which directors and managers are hired and
remunerated, financial matters and the company’s budgets and financial
35 plan.
- (5) Memorandum and Articles of Association of West Register.
- (6) West Register’s financial statements for the years ended December 2009,
2010 and 2011 stating that its policies are set by its parent entity, RBS.

Witness evidence

26. The Tribunal heard oral evidence from Mr Philip Richard Evans, Finance
5 Director of Monitor Audio who appeared on behalf of the Appellant.

27. Mr Evans' witness statement of 18 August 2014 was taken as read. Mr Evans
was not cross-examined but did elaborate for the Tribunal; the role played by the
Investor Director (referred to in the Shareholders Agreement after the 2009 re -
organisation) and the circumstances surrounding the new financing arrangements
10 entered into with HSBC to replace the RBS debt funding in 2011.

Total Capital

28. Mr Evans' witness statement explained Total Capital's investment in Monitor
Audio in 2007 describing it as "at arm's length" with no active involvement in the
conduct or operation of Monitor Audio. Mr Evans explained that the management
15 team had discussions with 10 venture capital providers before picking Total Capital,
partly because their offer gave the management team the most independence. He said
that Total Capital's investment was not strategic or structural; they invested in
Monitor Audio knowing there was a fairly high degree of risk. Their expected return
was in excess of 20% which is commensurate with the venture capital industry. It had
20 been confirmed to Mr Evans by a Total Capital representative in 2007 that their
investment was geared towards a 3 to 5 year exit strategy.

29. Mr Evans referred to RBS' and publicly available information that West
Register was part of RBS' "Strategic Investment Group", which was itself part of
RBS' Global Re Structuring Group. He referred to an article from the Financial Times
25 suggesting that RBS' Strategic Investment Group was run like a private equity firm.
Mr Evans also referred to West Register's accounts for 2009 and 2010 which
described its activities as an "*equity investment company, subscribing for equity
securities that offer it the opportunity for returns through dividend income and fair
value gains*".

30 *The Investor Director*

30. Mr Evans said that the Investor Director attended and voted at board meetings
of Monitor Audio. The Investor Director had the same rights to comment at and vote
in board meetings as the other directors. The Investor Director (Mr Miller) was
appointed in September 2010 and was a non executive director. The Investor Director
35 did have some matters on which his consent was required but none of these (set out in
Schedule 9 of the Shareholders Agreement) were pertinent to the day to day running
of Monitor Audio's business. For example, as far as authorising Monitor Audio's
budgets was concerned, one had been authorised and consented to by the Investor
Director but one had not been authorised, nevertheless Monitor Audio had
40 implemented that budget.

31. Mr Evans said that the key decision makers for Monitor Audio were the management team of himself and four other directors, not including Mr Miller. It was that team who made strategic and planning decisions for the company and took full responsibility for changes to the business model, including for example the refinancing in July 2011. Mr Miller had no direct involvement in the management of the business.

The 2011 refinancing

32. Mr Evans said that Monitor Audio replaced RBS' financing with financing from HSBC in 2011 because HSBC offered an "invoice package" which allowed for invoice discounting to be set off against the debt owing meaning that re-payments were not required on the debt. Discussions were carried out with RBS about this refinancing but they could not offer this facility and did not make a counter offer of funding to Monitor Audio in 2011.

Preliminary matters:

33. Both parties were aware that the definition of a "venture capital company" for these purposes was being considered in a current case and agreed that they would like the opportunity to make further written submissions if relevant concerning the meaning of a venture capital company when that decision, the Scottish Tribunal case of *Pyreos* was handed down. That decision was published shortly after this hearing on 18 March 2015 and the parties both submitted further arguments on the meaning of a "venture capital company" in the light of that decision after the date of the hearing.

34. The Tribunal was informed that both RBS and West Register had declined to be involved in these proceedings.

Taxpayer's Arguments.

Institutional Investor

35. There was agreement between the parties that there was no specific definition either in case authorities or in any UK or EU statute of an *institutional investor*, therefore it was legitimate to assume that the term took its ordinary commercial meaning; Ms Fairpo referred to the Cambridge Commercial Dictionary meaning of an institutional investor as "*an organisation, for example a bank or an insurance company, that invests in something*".

36. Ms Fairpo resisted HMRC's suggestion that in order to fall within the definition of an institutional investor a company had to be making investments for a group of smaller investors on a pooled basis (such as through a mutual fund or a pension fund) as set out in HMRC's own guidance at CIRD 92200 "*the institution will act as a broadly transparent vehicle through which others may channel investments to gain economies of scale and spread investment risk*". In her view counter to HMRC's stated guidance, an institutional investor did not have to be in the form of a collective investment scheme.

37. HMRC's approach was an unmerited restriction on the term used and derived from examples give in the Guide which were intended to be illustrative and not definitive. They produced a definition which was far too narrow to be practicable and which ignored the reasons for adopting the Recommendation stated in its recitals. Ms Fairpo noted that a Regional Development Fund was mentioned in the Recommendation as an entity which would be an example of an institutional investor although such an entity did not fulfil the criteria which HMRC were suggesting were required.

38. Ms Fairpo also referred to another European Directive which did consider the definition of an institutional investor being Directive 2004/39/EC which regulates financial instruments and which includes within its list of entities which are required to be authorised: *credit institutions; investment firms; other authorised or regulated financial institutions; insurance companies; collective investment schemes and the management companies of such schemes; pension funds and their management companies; commodity and commodity derivative dealers; locals; other institutional investors*. She took the reference to "other institutional investors" at the end of this list to indicate that all other members of the list were institutional investors.

39. Ms Fairpo's approach was to consider both RBS and West Register separately to consider whether either fulfilled the definition of an institutional investor or a venture capital company although she made the point that as a 100% subsidiary of RBS, West Register could be taken to share its purposes.

40. The main thrust of Ms Fairpo's argument was based on the purpose of the legislation, which she said was to penalise only those SME's which, as a result of having a non-institutional investor, were in a better position than a normal SME, having access to better sources of funding or other support. She referred to Mr Evans' statements about the re-financing in 2011 to support her conclusion that RBS were not offering Monitor Audio any more favourable terms than would have been available from a third party lender such as HSBC. She referred to the discussion in the 1996 version of the Recommendation stating that: *"The purpose of the independence criterion is to ensure that the measures intended for SME's genuinely benefit the enterprises for which size represents a handicap and not enterprises belonging to a large group which have access to funds and assistance not available to competitors or equal size"*.

41. In this instance no additional support had been available from either RBS or West Register to Monitor Audio, the only "rights" which West Register had as a result of being a shareholder of Monitor Audio were defensive rights to protect their investment in the company and were not the rights of an active investor, as set out in Clause 7.11 Consent Matters and Schedule 9 of the Subscription and Shareholders Agreement. Moreover it was clear from the documentation which was produced for the re-structuring in 2009 that the parties considered RBS to be an investor. There was no evidence in the documents or from Mr Evans' witness evidence that either of these entities viewed their holding in Monitor Audio as either strategic or structural, as suggested to be required by HMRC's own guidance CIRD 92200: *"the European Recommendation also considers that the character of an institutional investor will be*

at arm's-length rather than through active involvement in the conduct or operation of the company in which the investment is made.... this would argue against the inclusion of strategic or structural investments”.

Venture Capital Company.

5 42. The Appellant’s alternative argument was that West Register was holding its shares in Monitor Audio as a venture capital company, as defined at Article 3(2)(a) of the Recommendation. Ms Fairpo took the approach that given that there is no EU based definition of a venture capital company, it should take its ordinary meaning.

10 43. HMRC’s manual at CIRD 92100 provides HMRC’s definition of a venture capital company:

15 *“[A]n institution providing, as its specialised business, finance to start-up or developing businesses, where a fairly high degree of risk is involved. The investment would be likely to be in the form of equity, but it may be supported by loans. One would expect a high return commensurate with the level of risk, and the company to be looking to realise its capital in successful investments as part of the overall business ... [HMRC would] expect the company to make a significant number of investments in different companies so as to provide the spread of risk that one would associate with the carrying on of a business, rather than simply the making of one or more speculative investments.*

20 *[HMRC] have seen examples of large groups that, through a group member, make strategic investments in new activities that have an obvious link with the overall business of the group. In these circumstances [HMRC] would be unlikely to consider that the company was acting as a venture capital company if its aims were closely linked with the strategic aims of the group business. In these circumstances [HMRC] would be more inclined to view this activity as the carrying out of an overall group purpose to expand the business by strategic investments rather than*
25 *Page 17 of 18 to invest for high growth and a lucrative realisation. But each case will need to be judged on its own facts”*

30 44. Ms Fairpo pointed out that there is no requirement that a venture capital company is investing on behalf of a third party even in HMRC’s definition.

35 45. Ms Fairpo referred to West Register’s accounts, its activities of holding shares in a number of companies and its description as having the business of “holding investments” which she said was consistent with it being a venture capital company. Its predecessor company, Total Capital was providing venture capital and the risk profile of the holding in Monitor Audio had not changed subsequently; the holding remained in a high risk category as made clear by Mr Evans. Its investments were intended to produce a high level of return reflecting the risk taken on these investments.

40 46. By reference to the decision of the Tribunal in *Pyreos*, Ms Fairpo referred to the dictionary definition of a venture capital company relied on by the Tribunal, as a company “*whose interest is in maximising the financial return on its investments in*

new businesses and speculative ventures”, suggesting that this was in line with West Register’s activities as described in its accounts and that as a matter of fact although West Register was not investing in a new company, its investment was speculative given the risks involved in investing in the Appellant.

5 47. For the Appellant Ms Fairpo also relied on the approach of the Tribunal which stressed the need to take account of the overriding principles of the Recommendation in providing support only to “*genuinely autonomous companies*”. In the *Pyreos* case the investing company was treated as a venture capital company despite being a subsidiary in the same group of companies as the taxpayer; on the facts of this case
10 the Appellant was more autonomous and therefore West Register should fulfil the definition of a venture capital company.

HMRC's arguments:

15 48. On behalf of HMRC Mr Saunders argued that the context of the enhanced claim for research and development allowances was that it was an illegal state aid payment (as defined by EU legislation) which could only be allowed if it fell within certain specific exceptions set out in the EU's Recommendation. This was an exclusion from a prohibition and so any question of interpretation should be construed narrowly. If there was any doubt about its application, a restrictive interpretation should be applied.

20 49. HMRC's interpretation of the UK legislation ensured that its terms were applied restrictively and the Tribunal should be cautious to go beyond that for fear of allowing a payment which was contrary to EU state aid rules which clearly bound the Tribunal as made clear in the *Western Ferries* case, in the context of tonnage tax and state aid: “*it is plain that the intention of parliament must have been to enact a provision which*
25 *was consistent with the Commission’s views on tonnage tax, which did not fall foul of its Treaty obligations in relation to state aid and which would not lead to infringement proceedings by the Commission against the United Kingdom*”. [at paragraph 163]

30 50. In interpreting the Recommendation it was legitimate to take account of the reasons stated for its adoption as made clear by the Advocate General Jacob in the *Italian Commission* case “*we are entitled to interpret and apply the criterion of independence in accordance with its underlying rationale as expressed both in the Guidelines and the preamble to the Recommendations*” [at paragraph 33]. An approach which was also accepted in the *HaTeFo* case.

35 51. All relevant EU cases (including the *Italian Commission* case) suggested that the state aid legislation had to be construed in a restrictive manner. HMRC's internal guidance in their manual at CIRD 92200 was in line with that approach. The onus was on the Appellant to provide positive evidence that it came within the exception for institutional investors and no specific evidence had been provided either for West Register or for RBS. The relief should only be available to “genuine” SMEs as stated
40 in the *HaTeFo* case: “*The advantages afforded to SMEs are in most cases exceptions to the general rules, such as for example in the area of State aid, and therefore the definition of an SME must be interpreted strictly*”. [at page 145]

Institutional Investor

52. The term *institutional investor* should be given its natural and ordinary meaning. An institutional investor is an investment organisation which aggregates investments from a number of, or on behalf of small investors, such as a pension,
5 mutual fund or private equity firm. The investment arm of a commercial bank is not an institutional investor.

53. If RBS as a commercial bank can be treated as an institutional investor, so could almost any limited company, which would undermine the intended restrictions in the Recommendation. West Register was investing on its own account, the only
10 beneficiaries of its investments were itself and its shareholder RBS.

54. HMRC relied in particular on the Guide's reference to the meaning of an institutional investor, (at Chapter 2, Page 18 sidebar) "*They are usually seen as investors which trade large volumes of securities on behalf of a great number of individual small investors and which have no direct involvement in the management
15 of the firms they invest in. Mutual funds or pension funds, for instance, may be considered as institutional investors*".

55. Other guidance, such as the Financial Instrument Regulations referred to by the Appellant were not a reliable guide to the meaning of an institutional investor because those Regulations were intended to have a wide scope to bring within their ambit
20 entities trading financial instruments which were caught by EU regulations. The reference in that regulation to "other institutional investors" could be read either way and did not necessarily imply that the specific entities listed were also institutional investors.

Venture Capital Company

25 56. Mr Saunders accepted that venture capital companies suffered from an equal lack of statutory or case authority definition. HMRC's guidance stipulated that by their nature they should be making a range of high risk investments as set out in HMRC's guidance. Mr Saunders referred to the French version of a venture capital companies; *societies de capital a risqué* to indicate their general character. In order to
30 be a venture capital company, the company had to be an investment entity, it was not enough that it held one or two high risk venture capital type investments. RBS by its nature as an investment bank could never be said to be a venture capital company. No evidence had been provided that West Register fulfilled that definition either. When questioned Mr Saunders accepted that there was equally no positive evidence that
35 West Register and RBS did not fulfil these criteria, but stated that on the basis of the available evidence the Appellant had not made its case.

57. As to the documents which were provided relating to the debt restructure and the ensuing shareholders rights, HMRC's position was that the Investment Director did have rights to influence the affairs of Monitor Audio. The fact that in practice any
40 such rights had not been exercised was not relevant.

58. Whether West Register is an institutional investor or venture capital company is a question of what West Register invests in and how it does so; it is not about how it manages its stake in Monitor Audio, it is about its own characteristics.

59. By reference to the Tribunal's decision in *Pyreos* HMRC pointed out that the Tribunal in that case had failed to refer to the definition of a venture capital company provided in the 15 May 2014 "Evaluation of the User's Guide to the SME Definitions" which included as part of its suggested revisions to the Guide a definition of a venture capital company as "*a private equity/venture capital investment fund is a vehicle for enabling pooled investment by a number of investors in equity and equity related securities (such as quasi-equity) of companies (investee companies)..... In practice venture capital companies usually invest in growth orientated, often start-up companies, always with the intention to participate in the growth of the shareholder value by gaining profits from the exit.....*". HMRC stressed that this definition is consistent with the definition in their own guidance and has two aspects; that the investment should be pooled and that the investment should be in speculative ventures.

60. In HMRC's view West Register did not fulfil either of these criteria; West Register did not pool the funds of investors and neither did it invest in early stage speculative equity holdings with a view to "maximising investments". In West Register's case the investment in Monitor Audio was not speculative; the reason for the investment was to obtain better security for RBS for its original lending through the debt to equity swap. West Register did not fulfil the definition of a venture capital company.

Findings of Fact

61. On the basis of the evidence provided the Tribunal has made the following findings of fact:

(1) The matters over which the Investor Director was obliged to give consent in relation to Monitor Audio as set out in Schedule 9 of the Subscription and Shareholders Agreement were detailed and extensive, including the making of any material change to the company's business, the adoption of a budget for each financial period, the appointment and remuneration of directors and the entering into of certain contracts by the company.

(2) In practice the Investor Director was not involved in managing the company on a day to day basis and did not always exercise its rights under Schedule 9.

(3) The strategic management of the company was undertaken by its core director team not including Mr Miller as the Investor Director

(4) The investment by Total Capital in Audio Monitor was viewed as a high risk, short to medium term investment by that entity in 2007.

(5) West Register has its policies set by RBS so it cannot be regarded as an entity separate from the bank and that the characteristics of the two entities are substantially the same in respect of their dealings with Monitor Audio.

5 *Decision*

Approach to interpretation of State Aid Provisions

62. We take on board the general points of interpretation made by the parties, both that the terms in dispute here form the basis of an exemption from a restrictive piece of EU legislation and so should be narrowly construed and that it is permissible to
10 take account of the stated purpose of the Recommendation in its recitals relating to SMEs in considering how they should be applied.

63. The Tribunal does not consider it surprising that neither the term institutional investor nor venture capital company are specifically defined in the Recommendation since they are well known market terms. The usual meaning of both of those terms is
15 considered to be within judicial knowledge; the usual sense of an institutional investor connoting an institution whose function is to invest on behalf of others in a wide range of ways, as opposed to a private or retail investor. The usual meaning of venture capital company being, as suggested by the Tribunal in the *Pyreos* decision, a company whose strategy is to invest in high risk, high return ventures. We consider it
20 a feature common to both types of investor that they are not involved in the day to day management of their target investments.

Institutional Investor

64. We agree with the Appellant that in providing their guidance and their views in this case, HMRC have taken the illustrative examples provided in the Guide and
25 treated them as definitive. There is no support in the legislation for such a restrictive approach. Nor is there any commercial logic in HMRC's demarcations. It is a false distinction to suggest

(1) That investment banks do not invest on behalf of others; they invest and manage investments for other institutional investors, including pension funds and insurance companies and do not in fact generally hold equity investments
30 on a proprietary basis.

(2) That those types of entity which HMRC accept to be institutional investors always invest on a pooled basis; for example investment trusts manage investments for a large number of individual investors but these are not held on
35 a pooled basis.

(3) HMRC's category of acceptable institutional investors includes private equity funds but these do not invest mainly for small investors and are often spin-outs from investment banks.

65. The real comparison is not between pooled and non-pooled investment vehicles
40 but between private and institutional investors, with the former more likely to take a

direct interventionist role in the management of the companies in which they invest. This is supported by the substance test included in the recitals to the Recommendation and HMRC's own guidance at CIRD 92200. The essential test, as referred to by Ms Fairpo is whether RBS and or West Register by their structural or strategic involvement in the company, are putting Monitor Audio in a stronger market position than other SMEs; the best evidence for this is

(1) The extent of the involvement of West Register and or RBS in the day to day management of Monitor Audio, which on the basis of the corporate documents which we saw setting out the role of the only director of Monitor Audio appointed by West Register, the Investor Director and the clear evidence of Mr Evans, was very little. Although the Investor Director had a right to block a wide range of decisions taken by Monitor Audio (those set out in Schedule 9 of the Shareholder and Subscriptions Agreement), that right represented not a positive involvement in deciding how the company was run, but a negative veto against decisions not considered to be favourable to the Lead Investor, West Register. Moreover it was made clear by Mr Evans that Mr Miller, as Investor Director was not in practice involved in making day to day decisions about how the company was run and in some cases failed to exercise the rights which he did have (such as to authorise budgets).

(2) The discussions surrounding the restructuring in 2011 are also telling in this regard: Monitor Audio went to another bank, not RBS, which was offering more favourable terms when it needed re-financing, countering any suggestion that RBS' position as a linked partner enterprise was putting Monitor Audio in a stronger financial position or giving them substantially more economic power than a typical SME.

66. HMRC attempted to argue that the point in issue was about West Register (and RBS') own characteristics and not how they managed their investment in Monitor Audio. While we agree that the test applies at the level of those entities, we do think how they managed their stake in Monitor Audio must be indicative of the nature of their business. This is referred to in the sidebar note in the Guide which refers to entities "*which have no direct involvement in the management of the firms they invest in*" which we also considered to be a good general description of an institutional investor.

67. In the Tribunal's view it would have been a surprising conclusion that RBS was not an institutional investor. West Register as a 100% subsidiary of RBS with policies set by its parent shares its character and there is nothing to suggest that the Tribunal should come to a different conclusion if it viewed West Register in isolation. For these reasons we have concluded that both RBS and West Register can properly be described as institutional investors in Monitor Audio.

40 *Venture Capital Companies*

68. Given our conclusion above, the answer to the Appellant's alternative argument, that West Register should be treated as a venture capital company is of limited relevance. No evidence was given to the Tribunal about how this investment was

treated from a risk perspective by either RBS or West Register. We were referred to West Register's own accounts which described it as investing in shares for capital growth and dividend returns.

5 69. The only other relevant evidence which the Tribunal received was the second hand evidence from Mr Evans that West Register (and its predecessor) were part of RBS' investment banking arm which took high risk equity positions, akin to a venture capital entity and that this investment was considered to be high risk at the time when it was held by Total Capital back in 2007.

10 70. HMRC's guidance suggests that one indicator of an investor who should not be treated as a venture capital company is if its strategic goals are aligned with the target company's. We saw no indication in the evidence that this was the case. As we have already concluded, West Register took no positive role in managing Monitor Audio's manufacturing business and its strategic goals were not aligned with the success of otherwise of Monitor Audio's business of manufacturing loud speakers.

15 71. We have treated with some caution HMRC's reference, in the light of the *Pyreos* case to what they refer to as the "definition" of a Venture Capital Company provided by the 2014 "Evaluation of the User Guide to the SME Definitions". Despite what is said by HMRC, that document is a collation of comments on the Guide and far from providing new definitions, makes clear that further definitions of terms such as Venture Capital Company would go beyond the scope of the original text of the Recommendation. Any changes proposed are suggestions only and even those suggestions are to be included in the form of a glossary rather than new definitions. We do not agree with HMRC that the proposals made in that document should be treated as providing a definitive view of what entities should be treated as venture capital companies for these purposes.

20 72. Overall, the Tribunal has not felt able to come to a firm conclusion on this point on the basis of the rather limited evidence provided about West Register's activities, strategies and risk appetite for the relevant periods. We agree with HMRC in this respect that the concept of a venture capital company entails more than establishing what is done for one particular investment and goes to the character of all the investments held by a particular entity, about which we have very limited information.

73. For these reasons the Tribunal has concluded that the Appellant has not demonstrated that West Register can be treated as a venture capital company for the relevant periods.

35 *Conclusion*

74. The Tribunal holds that both West Register and RBS fulfil the definition of an institutional investor and that for this reason Monitor Audio can be treated as an SME for the periods under appeal. On these facts, we are not concerned that this gives too wide a scope to this exemption from the state aid rules since in substance the investment by West Register has not given Monitor Audio access to support greater than it would have had had West Register and RBS not been shareholders, either in

terms of day to day management or access to capital. For these reasons this appeal is allowed.

75. 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.

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**RACHEL SHORT
TRIBUNAL JUDGE**

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