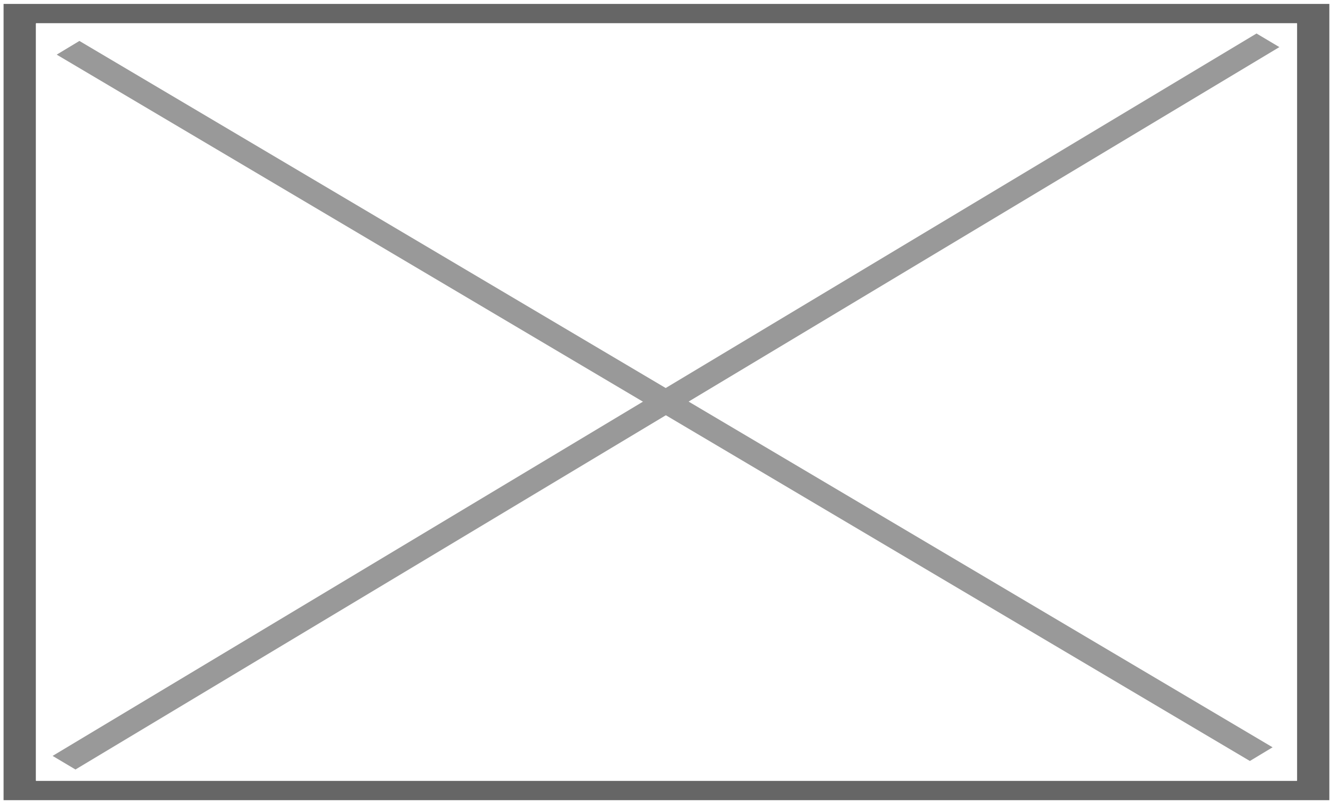
Skyfall – you only claim twice

Personal tax



01 October 2015

Keith Gordon reviews the First-tier's decision in *Ames*

Key Points

What is the issue?

The case of Ames concerns a claim for capital gains tax relief for an EIS investment in the absence of an income tax claim

What does it mean to me?

Unpicking the rather convoluted wording of the s 150A(3)(c) test reveals that the capital gains tax restriction applies only if the taxpayer subscribed for more EIS shares than qualified for income tax relief in the year in question

What can I take away?

Although Mr Ames lost his case on the arguments put forward, taxpayers in a similar position should consider s 150A(11). This states that the concept of relief being attributable to shares takes its meaning from the whole of Chapter 3, not just a single section

Ben Powell's article, 'Nurturing growth' (*Tax Adviser*, August), sets out the conditions that must be fulfilled if shares are to qualify for relief under the EIS and SEIS rules. However, as the recent decision in *Ames v HMRC* [2015] UKFTT 0337 (TC) (*Ames*) demonstrates, even satisfying the stringent tests that determine qualifying shares and qualifying investors can prove insufficient.

The facts of the case

Robert Ames was a skydiver. Recognising that the sport, if conventionally undertaken, had limited prospects in the UK, he and some associates established the country's first indoor skydiving simulator.

On 27 January 2005, Mr Ames subscribed for £50,000 fully paid shares in a company later renamed Airkix. About a year later, Airkix issued Mr Ames with form EIS3, which certified that the shares qualified for EIS relief.

At the time, Mr Ames had negligible income, just £42 in the 2004/05 tax year, well below his personal allowance. As a consequence, he was unable to claim any income tax relief on his investment.

In the meantime, Airkix prospered and in June 2011 Mr Ames sold his shares for £333,200 and claimed capital gains tax exemption in his 2012 tax return. HMRC, however, thought otherwise and opened an enquiry into the return. They pointed out that one of the conditions for the exemption was not met: the need for income tax relief to have been claimed. They duly issued a closure notice, charging Mr Ames £72,176.

The tribunal's decision

Mr Ames appealed against the closure notice and notified this to the First-tier Tribunal. The sole point of dispute was whether the absence of an income tax claim was fatal to the capital gains tax claim undeniably made by Mr Ames. The appeal was heard by Judge Anne Redston and Shameem Akhtar.

The tribunal's decision explains the complex legislation on EIS. The principal provision is TCGA 1992 s 150A. In particular, s 150A(2) provides that a gain should be exempted from capital gains tax if there was a disposal after the minimum holding period, which there was, and 'an amount of relief is attributable to the shares'. That phrase is picked up by subsection (11), which provides that 'Chapter 3 of Part 7 of [ICTA 1988] applies for the purposes of this section to determine whether relief is attributable to any shares and, if so, the amount of relief so attributable'.

This reference then took the tribunal to look at ICTA 1988 sections 289, 289A and 289B, which deals with the income tax side of EIS relief for shares issued before 6 April 2007.

Section 289 contains the main conditions for an individual to qualify for EIS relief. In Section 289A is the provision that states that, if an individual who is eligible for relief makes a claim, his income tax liability for the year in which the shares were issued will be reduced by the lower of:

1. the lower rate of income tax for the year as applied to the amounts subscribed for eligible share in the year; and
2. the amount that will reduce the taxpayer's income tax liability to nil.

Section 289B is headed ‘Attribution of relief to shares’. Section 289B(1) provides that any reference to ‘the relief attributable to any shares … shall be read … as references to any reduction made in the individual’s liability to income tax which is attributed to those shares’.

The tribunal then reverted to TCGA s 150A, this time to subsection (3). That provides for a restriction in the availability of capital gains tax relief, but applies only in some cases. First, it is predicated on situations in which there has been an income tax reduction; second, s 150A(3)(c) requires that income tax reduction must not have been restricted. Once one unpicks the rather convoluted wording of the s 150A(3)(c) test, it turns out that the capital gains tax restriction applies only in cases where the taxpayer subscribed for more EIS shares than qualified for income tax relief in the year in question. In such cases, s 150A(3) ensures that the capital gains tax relief is similarly restricted by the same proportion.

Mr Ames accepted that, in accordance with a straightforward interpretation of the statutory tests, his claim for capital gains tax relief was dependent on there having been an income tax reduction attributable to his EIS shares. However, he noted s 150A(3)(c) – or to be precise, its predecessor – which had been added by FA 1995 as part of a range of corrections to the legislation to ensure that the EIS scheme ‘works as intended’. Mr Ames argued that, as a result, an individual with taxable income of £1 – and who could therefore reduce his tax liability by 20p – would gain full capital gains tax relief, whereas he was being denied any relief because he had no income tax liability and, therefore, nothing to reduce. He complained that the literal interpretation of the legislation gave rise to an anomalous outcome.

The essence of Mr Ames’s argument was that s 150A(3)(c) should be read so as to extend the exception to cases where there had been no income tax reduction at all to accord with what parliament must have intended. The argument proceeded along a so-called ‘reverse Ramsay’ argument in that Mr Ames had complied with the spirit of the legislation and therefore should have been entitled to the relief that the legislation had sought to confer.

The tribunal, however, considered that the legislation was sufficiently prescriptive to preclude it giving it the ‘purposive’ meaning sought by Mr Ames.

It went on to consider whether human rights law could give Mr Ames a way out, but again decided that no aspects of his rights had been breached.

The tribunal also considered the possibility of Mr Ames making a late claim for income tax relief or to require HMRC to exercise their discretion under their care and management powers (now renamed more ominously as collection and management powers). However, the tribunal concluded that it did not have the jurisdiction over such matters and that Mr Ames would be obliged to consider judicial review.

For these reasons the tribunal dismissed Mr Ames’s appeal.

Commentary

I infer from the decision that the tribunal was not enthusiastic about dismissing the appeal and that it felt obliged to give a result that it considered to be unfair.

The result is definitely unfair. Further, it is the kind of case that gives the UK tax system a bad name. On the assumption that the decision is correct, it is inexcusable that, in the second decade of the 21st century, tax reliefs can be denied for such capricious reasons. The relief was introduced to encourage people like Mr Ames to make a commitment to growing companies; why should Mr Ames be disqualified from the relief simply because he was not rich enough to make an income tax claim in relation to the year in which the shares were issued?

If the government is serious about encouraging venture capital, it should immediately rectify the legislation to get rid of these unnecessary traps for the unwary. Otherwise, the message to taxpayers and other investors is that tax reliefs are merely an illusion and that the wise investor would be better off considering a different jurisdiction.

Nevertheless, given the arguments led by Mr Ames, it is difficult to see how the tribunal could have reached a different decision. But I do wonder whether a different outcome could have been reached if different arguments had been put forward.

In particular, Mr Ames focused on s 150A(3) and sought a creative extension of para (c) to bring in another category of exception to that subsection. That subsection provides that, except in the cases specified by para (c), capital gains tax relief is restricted if income tax relief itself has been restricted. However, an alternative view could be to dispense with subsection (3) altogether. After all, one of the conditions for subsection (3) to apply is set out in para (a), 'where an individual's liability to income tax has been reduced'. As is clear, Mr Ames's income tax liability had not been reduced (not even by a penny). Therefore, subsection (3) is not in point.

Mr Ames should instead have focused on subsection (2), which confers relief when the statutory conditions are met. The statute provides that, in those circumstances, full relief is available – subsection (3) is invoked only afterwards – to restrict the relief in particular situations. As long as we can place Mr Ames in subsection (2), we are home and dry. As Mr Ames was not caught by subsection (3) via para (a), there was no need for him to try to escape its clutches by extending the scope of para (c).

Of course, there is a difficulty in showing that Mr Ames qualified for the capital gains tax relief in the first place. This is because subsection (2) turned on there being 'EIS relief … attributable to the shares' and the references back to ICTA 1988.

It is here where I consider that Mr Ames advanced the wrong arguments and, had the opportunity arisen, where the tribunal might have been able to reach a different conclusion. As the tribunal correctly noted, the concept of EIS relief being 'attributable' to shares is found in sections 289 onwards of ICTA 1988, the signpost being provided by TCGA 1992 s 150A(11), with s 289B in particular determining how much relief is to be attributable to any particular share.

However, what I believe Mr Ames overlooked was that s 150A(11) refers to two distinct concepts that are obviously related: first, whether relief is attributable to shares; and second, on the assumption that it is, how much is attributable to the shares. Section 289B, which contains the requirement that income tax be reduced, deals only with the second of these two concepts.

With this in mind, one can revert to s 150A(11). It can now be seen that the concept of relief being attributable to shares takes its meaning from the whole of Chapter 3, not just a single section. Further, it can be seen that there is no actual definition of the concept within Chapter 3, only the definition of how much relief might be attributable. For this reason, the word 'attributable' can now be given its normal meaning of 'capable of having (relief) attributed'. In Mr Ames's case, all of his shares were capable of having EIS relief attributed to them because, as was common ground, all the conditions for income tax relief were satisfied.

In short, Mr Ames was not required to have made an income tax claim for an income tax reduction; Mr Ames's entitlement to capital gains tax relief should therefore have followed.

The downside of this argument is that it could be seen to permit unlimited capital gains tax exemption on EIS shares (as long as the investor makes no income tax claim). But the likelihood of this happening is minimal. In particular, it would be unusual for an investor to forgo the certainty of valuable income tax, in the hope of increased capital gains tax relief, particularly given the inherently risky nature of EIS investments. Further, given that the original legislation was admittedly flawed – in that it needed to make repairs in FA 1995 to deal with cases in which a taxpayer was unable to take full income tax relief – it is arguable that the legislation also contained a flaw dealing with cases at the other end of the scale.

Alternatively, or perhaps in addition, Mr Ames might also have succeeded had he taken a slightly different approach to his arguments for a purposive interpretation. I do think that talk of 'reverse-*Ramsay*' is sometimes unhelpful. The *Ramsay* doctrine, as clarified in the past 10 years, is simply that all legislation, tax legislation included, has to be interpreted by applying it purposively to the facts, as viewed realistically. There is, or should be, no distinction between the avoidance cases in which the *Ramsay* doctrine was developed and any other kind of case. It is not permissible for a court to cite *Ramsay* in any case just to patch up apparent gaps in the statute. Therefore, on the basis on which Mr Ames advanced his case, the tribunal was bound to conclude that the legislation could not be read to accommodate his claim.

However, perhaps consider the Court of Appeal's decision in *Pollen Estate Trustee Company Ltd and King's College London v HMRC* [2013] EWCA Civ 753 ('Mind the (property) gap', Tax Adviser November 2013). In that case, the court felt able to fill an erroneous gap in the legislation to fulfil the clear policy that parliament was trying to lay down. The conditions laid down would seem to apply in the present case.

Further information

Read Ben Powell's article 'Nurturing growth'.