

## McQuillan and ordinary share capital

### The taxpayer is denied entrepreneurs' relief.

The case of *McQuillan v HMRC* [2017] UKUT 344 (reported in *Tax Journal*, 15 September 2017) gave rise to a very interesting (or rather, extraordinary) issue. It concerned the entitlement to entrepreneurs' relief and whether the 5% shareholding requirement was satisfied.

Mr and Mrs McQuillan each held 33% of the (full strength) ordinary shares in a trading company. Some other shareholders had 30,000 non-voting shares which had no rights to dividends.

The problem was that if the 30,000 non-voting shares were 'ordinary shares' for the purposes of entrepreneurs' relief, the taxpayers would obviously not have the necessary 5% of the ordinary share capital and would therefore not qualify for the relief.

The definition of ordinary share capital for this purpose is found in ITA 2007 s 989 and provides as follows: '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.'

### I wonder if there should be a campaign for a 'reverse GAAR'

The non-voting shares were obviously part of the issued share capital and could only be disregarded if they had a right to a dividend at a fixed rate. The First-tier Tribunal (FTT) therefore had to decide whether having no rights to a dividend was the same as having a right to a dividend at a fixed rate; i.e. a rate of 0%.

HMRC argued that the shares did not have a right to a dividend at a fixed rate – they did not have a right to a dividend at all – and could not therefore be excluded from the definition of ordinary share capital. The fact that this gave rise to a grotesquely unfair result which could not possibly have been intended by Parliament (does this resonate with anybody?) made no difference.

It seemed to me that the taxpayer had a really difficult argument. How can the absence of a right really be described as a right at 0%? For example, if I buy a car, should obviously not give me the right to a refund of my TV licence fee. However, nobody in their right mind would say that the purchase of the car gives me a right to

a TV licence refund at a rate of 0%.

However, the FTT was clearly seized by the need for justice and fairness. It found that in these circumstances the absence of a right to a dividend was equivalent to a right to a dividend at a fixed rate and allowed the relief. Obviously, this was a triumph for common sense (and fairness), even if the analysis was difficult to follow.

The matter might have simply been left there (perhaps pursuant to a need for fairness and justice) – but regrettably not. HMRC appealed to the Upper Tribunal, which concluded that having no right to a dividend cannot be regarded as a right to a dividend at a rate of 0%. The Upper Tribunal was really sympathetic and tried its best, but it could find no construction (purposive or otherwise) that could prevent these shares from being ordinary share capital within the definition in s 989. It recognised that this was just the sort of case for which entrepreneurs' relief was devised and that this interpretation appeared unfair, but found it impossible to conclude that Mr and Mrs McQuillan were entitled to entrepreneurs' relief.

I wonder if there should be a campaign for a 'reverse GAAR'. ■

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## New tax gap figures

### Where's the greatest risk?

The central public narrative about tax over recent years is that there is massive tax leakage due to the aggressive avoidance activities by multinational companies, and if only that could be stopped the country would be in much better economic health. That was a complete caricature and the latest tax gap figures published by the Treasury show just how wide of the mark this perception is.

The tax gap is the difference between the actual tax collected and the amount which in theory should be collected. The latest figures show that the gap has actually gone up slightly in real terms (£34bn from £33bn) but because tax revenues have increased, the gap as a percentage has reduced slightly, from 6.1% to 6%. Given the uncertainty in many of the underlying figures (after all, how do you accurately measure the tax due from people who are moonlighting?) and the rounding involved in getting to numbers in the billions, the overall picture is probably that there has been very little change since last year. But there is definitely a long-term trend downwards from the 2005/06 figure of 7.9%. This does reflect

HMRC's determined attempts to tackle non-compliance in all its forms and the department deserves credit for its achievements.

But back to avoidance by multinationals. The first thing to say is that avoidance as a whole is the smallest element in the tax gap. At £1.7bn, it is only 5% of the total. But delving deeper into the figures we see that the gap attributable to avoidance by the largest businesses is only £0.5bn. That is a very small proportion of the total tax gap of £34bn. We can debate whether or not this is due to increased HMRC compliance success or a move away from avoidance from the largest companies. In truth, it is probably a combination of the two. But it is clear that the public perception that 'it is all the fault of multinationals' has no rational basis.

### Avoidance as a whole is the smallest element in the tax gap

So, what do the figures actually show? The sector which contributes most to the tax gap is small and medium-sized businesses at £15.5bn, and of that the biggest element is failure to take reasonable care. In effect, businesses getting in a muddle over their tax affairs and not giving tax compliance enough attention. The tax gap on that alone is more than ten times that due to avoidance by large companies.

Deliberate non-compliance in all its forms – from under declaring income to non-payment and criminal activity – accounts for something like £14bn of the total tax gap. As we have said many times before, HMRC needs to be doing more, and be seen to be doing more, to tackle deliberate non-compliance. The battle against avoidance has largely been won and we need to see a shift in the public debate to ensure that evasion in all its forms is seen by everybody as unacceptable.

Any tax gap figures need to be treated with a healthy pinch of salt, simply because measuring the unknown is always going to be difficult. These figures recognise this by giving a range of possibilities. For example, the gap for self-assessment is shown as £6.5bn but this is within a range of possible amounts from an upper estimate of £14bn and a lower estimate of £2.4bn. It is the trends and make-up of the figures, rather than their absolute values, which matter. The government and HMRC have, understandably, put a positive spin on the figures. I think that is justified so long as it means that future policy is based on intelligent analysis of what these figures actually say. ■

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