DRN-4736416

The complaint

Mr M complains that Sapia Partners LLP invested the CHF Media Fund (the fund) it managed in two companies when it shouldn't have because they were at risk of losing their Enterprise Investment Scheme (EIS) status following the Patient Capital Review (PCR) carried out by the government.

What happened

In 2018 Mr M subscribed to the CHF Media fund for which Sapia was the discretionary fund manager. In that capacity it invested Mr M's money in CHF Pip! Plc (Pip) and Daisy Boo and Monkey Too Ltd - which changed its name to Hoopla Animation Limited in March 2019 and is how I will refer to it throughout - in March and April 2018.

HMRC had previously confirmed in 2011 that shares issued by Pip qualified for EIS relief. For Hoopla advanced assurance that it was entitled to issue shares that would qualify for EIS relief was sought and obtained in 2014 with HMRC thereafter issuing compliance certificates for shares issued up to 13 March 2018 allowing EIS relief to be claimed in respect of those shares.

However, on 20 July 2018 HMRC asked Hoopla to provide further information about its business activities over the past three years and following a response then asked for further information specifically to assess whether it satisfied the 'risk to capital' condition that had been introduced into the Income Tax Act 2007 on 15 March 2018. It thereafter refused to issue the necessary compliance certificates for shares issued between 19 March 2018 and 19 October 2018.

Hoopla asked HMRC to review its decision and when it maintained its original decision Hoopla appealed its decision to refuse to issue the necessary certificates. The appeal was heard in 2023 and was unsuccessful. Hoopla had in the meantime restructured with a view to satisfying the risk to capital condition.

In respect of Pip HMRC also asked for it to provide further information after the introduction of the risk to capital condition. Following this being provided it concluded that shares issued between May 2018 and November 2018 didn't qualify for EIS relief because Pip didn't satisfy the risk to capital condition and it refused to issue certificates for the shares. Pip asked for a review by HMRC and when this was unsuccessful appealed which appeal was also unsuccessful. Administrators were subsequently appointed in March 2021 and the company was ultimately dissolved on 30 April 2023.

Sapia didn't uphold the complaint made by Mr M. In short it made the following points:

- The PCR was first announced by the UK government in November 2016 with an industry panel response published in October 2017 following which there was no immediate potential or actual impacts upon the fund or its portfolio companies.

- At the time of Mr M being invested into Pip and Hoopla it wasn't aware of any potential or actual impacts upon the fund, or the companies, linked to the risk of EIS

disqualification.

- The consequent disqualification issues concerning the two companies only came to light after Mr M's funds had already been invested and it refutes that it knew before this that there was any change to the material risk of the companies qualifying for EIS status.

- The Information Memorandum (IM) outlined that it didn't have any responsibility to advise any investor on financial and tax related matters or a proposed investment in the fund.

- It didn't seek further assurance from HMRC regarding the companies EIS qualification status.

- As manager of the fund it was responsible for risk-management related matters and any potential or actual identified risks or other material negative impacts upon the fund and its investors were monitored on an ongoing basis.

One of our investigators considered the complaint but didn't think it should be upheld. In short he made the following points:

- Sapia couldn't have known that Pip and Hoopla would be affected by the PCR at the time Mr M invested and were only alerted that the companies could potentially lose their EIS status after this.

- Sapia has taken action to try and prevent the loss of EIS status once it was aware this was a possibility through restructuring Hoopla and by appealing the decision about Pip.

- Mr M appointed Sapia as discretionary fund manager in respect of his investment in the fund and agreed to it making decisions on his behalf and this didn't require it to inform him about issues with underlying companies.

- The IM provided to Mr M before he invested explained the risk that companies could lose their EIS status.

Mr M didn't agree with the investigator about Sapia being unaware there was a potential risk Pip and Hoopla could fail to qualify as EISs following the PCR. He referred to an email to him from Kuber, the promoter of the fund, dated 21 May 2021 in which it referred to Sapia contacting HMRC following the PCR seeking assurance that the qualifying EIS status of Pip and Hoopla hadn't been affected but that it didn't get such assurance. He pointed out that the senior people at the time at Sapia are no longer there and it has outsourced its compliance work. He suggests this could explain why it now says it didn't seek assurance at the time when Kuber says it did – in that the current senior people may be unaware that Sapia contacted HMRC and the evidence of it asking HMRC for assurance may have been lost.

Mr M also stated that Sapia went ahead with investment when it knew that the PCR was aimed at companies that were capital preservation in nature and it was apparent to all industry professionals that previous advanced assurances from HMRC for companies such as Pip and Hoopla were at risk as they were structured and marketed as capital preservation EIS models.

As he disagreed with the investigator the matter was referred to me for review and decision.

I issued a provisional decision explaining why I didn't think the complaint should be upheld. The findings from my provisional decision are set out below.

"M has made clear his unhappiness with what transpired and his belief that Sapia was aware that Pip and Hoopla were at risk of not being EIS qualifying companies following the PCR. I acknowledge that HMRC concluded that the companies were not EIS qualifying within months of him investing and I understand why he feels Sapia should have anticipated this would happen.

However, I am not persuaded that it failed to comply with its regulatory obligations or

otherwise acted unreasonably in proceeding to invest his money in the two companies when it did for the reasons I set out below.

Given Mr M's reference to the PCR I think it would be helpful to explain briefly what this was and its bearing on this complaint. In short the PCR was a review led by HM Treasury and announced by the government in November 2016. The terms of reference were announced in January 2017 and stated it was to 'strengthen the UK further as a place for growing innovative firms to obtain the long-term patient finance that they need to scale up, building on best practices'.

An independent industry panel was appointed to develop and suggest a package of

recommendations, with its response being published in October 2017 with three specific initiatives being recommended. Sapia has said that there were no immediate potential or actual impacts on the fund from its recommendations.

I accept this, but there were other publications that did identify changes that could impact the companies the fund intended to invest in. In particular HM Treasury issued a consultation in August 2017 titled 'Financing Growth in Innovative Firms' and the response to the consultation was published in November 2017 ("treasury consultation response"). The response included clear reference to the introduction of a risk to capital condition.

There is an explanation that:

"The condition has two parts: whether the company has objectives to grow and develop over the long-term (which mirrors an existing test with the schemes); and whether there is a significant risk that there could be a loss of capital to the investor of an amount greater than the net return."

HMRC also published a policy paper on 22 November 2017 titled 'Income Tax: venture capital schemes – risk to capital condition' stating that this will affect certain companies and individuals using the EIS as well SEIS and VCTs. The paper explains that the condition depends on taking a 'reasonable view' as to whether an investment has been structured to provide a low risk return for investors'.

I think it is whether this 'risk to capital' condition – detailed in the publications in late 2017 that I have referred to above and introduced into the Income Tax Act 2007 as of 15 March 2018 - should reasonably have led Sapia to conclude that Pip and Hoopla would no longer be EIS qualifying that is the main issue I need to address in the complaint.

In considering that issue I think it is important to make clear that as a discretionary fund manager it was for Sapia to decide what it should invest the fund – and as such Mr M's monies – into. It didn't have to seek his approval for the decisions it took or provide information to him about its investment choices, as I think the IM for the fund made clear.

This included the following:

"The Investor's Agreement provides that the Manager is responsible for selecting suitable investee companies and investing Subscription Monies in them. The Manager will have total investment discretion with regard to selecting, monitoring, and realising Investments in accordance with the specified investment objectives and restrictions and in particular the need to comply with the rules set out in the Income Tax Act 2007 with a view to ensuring that the Tax Reliefs under the EIS and the SEIS accrue to the Investor."

The investors agreement was also included within the IM and included the following at clause 2.3:

"You, as the Investor, grant the Manager full authority, at the Manager's sole discretion and without reference to you, to enter the kind of transactions or arrangements for your account and to invest, on your behalf, in the type of investments or assets as set out in the Information Memorandum."

The investment objective of the fund was then identified as:

"To offer Investors the opportunity to invest in unquoted SEIS and EIS Qualifying Companies in accordance with the investment strategy set out on page 4 of the Information Memorandum."

The investment strategy sets out that the fund aims to invest in a selection of shows or concepts, both those in development and/or in production and that its investment into investee companies with shows or concepts in production should qualify for EIS relief while investment in investee companies with shows or concepts in development should qualify for SEIS relief.

On the face of it investment in Pip and Hoopla was in accordance with the investment

objective - given what those companies were involved with and the fact that HMRC had previously approved shares the companies had issued so that EIS relief could be claimed by investors. In the circumstances to uphold his complaint I would need to be satisfied that Sapia should have concluded that it was likely that the introduction of the risk to capital condition meant the companies would no longer be EIS qualifying. Having considered this carefully I am not satisfied that this was the only reasonable conclusion that Sapia could have reached at the time it invested Mr M's money in Pip and Hoopla.

I note that Mr M has said that it should have been apparent to Sapia that any previous assurance from HMRC couldn't be relied on because the companies were marketed as capital preservation models and this is what the PCR was aimed at. I have been provided with no evidence that Pip or Hoopla did target capital preservation. The IM for the fund states that the fund targets a return three times net investment after five years but the return could be many multiples higher and that:

"It is important that Investors invest in the CHF Media Fund for capital growth rather than for capital preservation, as there are no guarantees of returns."

In any event, whilst I acknowledge that businesses with a low risk capital preservation model may have been the target when it came to the risk to capital condition this doesn't mean the condition didn't allow for any element of capital preservation. As the treasury consultation response noted:

"A company may meet the condition and be eligible for investment under one or more of the

schemes even if one or more factors that are features of capital preservation are present."

So, even if Pip and Hoopla did make some reference to capital preservation, it doesn't automatically follow they couldn't still qualify as EISs because of the risk to capital condition. Moreover, Sapia didn't rely on previous assurances from HMRC as to the companies being EIS qualifying. In response to questions I put to it about the publications I have referred to above Sapia stated that it carefully considered the introduction of the risk to capital condition and approached HMRC in early 2018 for clarification on how it would apply this. Sapia said that in accordance with HMRC's standard response it referred Sapia to the guidance. Sapia said that having considered the guidance it concluded Pip and Hoopla would still qualify for EIS relief.

I note the previous indication given by Sapia in its final response to the complaint that it didn't contact HMRC before it invested in Pip and Hoopla in 2018. I think it is more likely than not there was contact as Sapia has now said is the case, given this is consistent with what Kuber stated happened in its email to Mr M and also what he has argued happened in any event.

Mr M suggests that Sapia contacting HMRC supports his complaint but I am not persuaded that it does. Such contact isn't, in my view, evidence that Sapia believed that Pip and Hoopla wouldn't continue to be EIS qualifying because they couldn't satisfy the risk to capital condition. It seems to me that contacting HMRC to seek assurance following the introduction of a new condition for companies to be EIS qualifying was simply a prudent step for Sapia to have taken in the circumstances regardless of its own views as to whether the companies would be able to satisfy the condition.

The fact that HMRC weren't then willing to provide any assurance and instead referred Sapia to the guidance doesn't then mean the only reasonable conclusion Sapia could have come to was that the companies wouldn't satisfy the condition. Sapia has said that having considered the guidance it concluded the companies would still be EIS qualifying and I am not persuaded that this was an unreasonable conclusion for it to have reached at the time.

It also seems to me the actions taken by Sapia in respect of both companies after HMRC refused to provide the necessary certificates for EIS relief to be claimed – namely asking for review of the decision and then appealing this – also suggests that Sapia was prepared to stand by the conclusion it had reached that the companies satisfied the condition.

Moreover, in the case of Hoopla the judge rejected HMRC's argument that the condition hadn't been met, refusing the appeal on another basis. So, in respect of that investment not only was Sapia's conclusion that the company satisfied the condition a reasonable one for it to have reached at the time it invested Mr M's money, it also was subsequently shown to have been right.

In the case of the appeal by Pip the judge did find there had been a failure to satisfy the risk to capital condition but it doesn't follow from this that it was unreasonable for Sapia to have come to a different conclusion at the time it invested Mr M in the company. Put another way, just because the judge agreed with HMRC doesn't mean it should have been obvious to Sapia that the condition wouldn't be met at the time it invested Mr M in the company such that it was unreasonable for it to proceed with investing."

I gave both parties the opportunity of responding and providing any further information they wanted me to consider before making my final decision. Mr M responded setting out why he didn't agree with my provisional decision. In summary he made the following key points:

- The core of his complaint is that Sapia failed to exercise a professional duty of care

he had a right to expect as through signing the IM he authorised it to ensure that he was invested in in a bona-fide EIS scheme and the scheme it chose didn't meet the EIS criteria and was subsequently refused by HMRC.

- There was sufficient prior evidence to suggest that this risk was known to Sapia and it was incumbent on it to mitigate this risk and at this point the prudent action would have been not to make the investment.

- Before investing his funds Sapia was fully aware of the PCR risk and particularly the November 2017 clarification on capital risk conditions to the respective EIS schemes for which it held advanced HMRC assurances - why else would Sapia contact HMRC for advice on the integrity of the assurances, something it initially denied doing.

- He agrees this was a prudent action but despite no further assurance and no recorded evidence of a risk review it went ahead based on its own interpretation of the guidelines.

- The ombudsman cites Sapia challenging HMRC as evidence it had confidence in its initial decision, but it had to do something to sort out the mess it had made.

- Both subsequent court judgments found fault with the respective schemes.

- The CEO of the new administrators wrote in August 2022 and apologised for the poor communication – neither Sapia nor CHF initiated any communications on the failure of the schemes. The CEO also refers to the retrospective changes made to the schemes to make them compliant with the new EIS guidelines, stating that this ensured the company had the objective to grow and make profit with the capital to remain at risk – the clear inference being from what he said that these conditions didn't exist in the original scheme.

- If Sapia had carried out even a basic risk review it would have identified these flaws.

- He fully understood the risk of the schemes. What he is incensed about is the cavalier attitude of Sapia that negated any reasonable risk review he made on the investment prior to signing the IM.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

In doing so, I've taken into account relevant law and regulations; relevant regulators' rules guidance and standards; codes of practice; and, where appropriate, what I consider was good industry practice at the relevant time. But I think it's important to note that while I take all those factors into account, in line with our rules, I'm primarily deciding what I consider to be fair and reasonable in all the circumstances of the case.

It is for me to decide what weight to give evidence a party relies on and where there is a dispute about the facts my findings are made on a balance of probabilities – what I think is more likely than not.

The purpose of my decision isn't to address every point raised and if I don't refer to something it isn't because I've ignored it but because I'm satisfied I don't need to do so to reach what I think is the right outcome. Our rules allow me to do this, and it simply reflects the informal nature of this service as a free alternative to the courts.

I have considered everything that Mr M has said in response to my provisional decision and understand that he strongly believes that Sapia is at fault for investing his monies in Pip and Hoopla following the changes to EIS rules implemented as a result of the PCR, in particular the introduction of the risk to capital condition.

However, I am sorry to disappoint him but I am not persuaded that I should change the findings in my provisional decision - which findings form part of my findings in this final decision unless I state to the contrary. I have already addressed Sapia contacting HMRC before investing. I note Mr M argues that this shows that Sapia was aware that the Pip and Hoopla were at risk of not satisfying the capital at risk condition and that when no assurance was forthcoming the prudent step was to decide not to invest in the companies.

However, as I have already said I think it was understandable that Sapia sought some direction from HMRC following the changes being brought about as a result of the PCR - in particular the addition of the risk to capital condition. I think it is unlikely that Sapia was the only business that will have made enquiries at the time to try and found out whether this would impact a scheme. Sapia has said that its standard response was to tell businesses to consider the guidance and I have seen nothing that suggests this wasn't the case and seen no evidence that HMRC was generally providing any assurance as to the new rule.

In the circumstances the fact that HMRC was unwilling to provide any direction to Sapia isn't evidence that it considered a scheme wouldn't satisfy the condition. HMRC's response was in my view neutral – it didn't take Sapia any further forward but equally didn't take it back either. As such, I'm not satisfied that the lack of direction from HMRC meant the only reasonable conclusion that Sapia could come to was that Pip and Hoopla were unlikely to satisfy the requirements for an EIS going forwards.

I think it was reasonable in the circumstances for Sapia to consider the guidance, as HMRC said it should, and come to its own decision. I acknowledge that Mr M doesn't think it came to the right conclusion. However, I am not satisfied that the only reasonable conclusion that Sapia could have reached after such consideration was that it was likely the two companies would no longer qualify as EISs and that it shouldn't invest client money in the schemes.

I have considered the letter Mr M has provided from the CEO of the new administrators in support of his complaint. He refers to an apology in the letter as to the lack of communication. The paragraph Mr M has referred to simply states that it is possible some investors may not have received communication. But regardless of whether there was an apology the key issue in this complaint isn't the communication by Sapia following HMRC's refusal to provide compliance certificates for shares on the basis Pip and Hoopla didn't satisfy the EIS requirements. It is whether Sapia was wrong to invest Mr M's money in the companies in the first place.

The second paragraph he has highlighted, which he refers to in support of his argument that Sapia was wrong to invest his money, is where the CEO refers to rebranding Daisy Boo and Money Too as Hoopla with the addition of new management team members and transfer in of most of the production team from CHF Entertainment following detailed discussions with HMRC. The letter states that *"this ensures that the company had the objective to grow, to make a profit and for capital to remain at risk thus meeting HMRC requirements for compliance.*

Mr M argues that the clear inference is that these objectives didn't exist in the original schemes. However, it isn't in dispute that this was HMRC's conclusion – and in respect of the risk to capital requirement the court found it had come to the wrong conclusion. The fact that the administrators subsequently had detailed discussions with HMRC about its requirements and took action to ensure Hoopla was compliant going forwards doesn't

provide persuasive evidence that Sapia should have concluded in 2018 that Hoopla (or Pip) wouldn't qualify as EISs.

In this regard I note that whilst the CEO has referred to steps that have been taken subsequently to satisfy HMRC, he also states that *"Hoopla has largely dealt with the effects of the unwarranted (*my emphasis*) loss of its EIS-eligible status in 2018".* So, whilst the administrators may have taken steps to satisfy HMRC requirements following subsequent detailed discussions as to what it required, they still appear to have been of the view in 2022 that HMRC's actions in relation to Hoopla in 2018 were unjustified.

In any event I am not persuaded that what the administrators said in 2022 is persuasive evidence that Sapia should have concluded in 2018 that HMRC were likely to conclude that Pip and Hoopla wouldn't satisfy the necessary requirements to qualify as EISs.

Mr M has said that both court judgments I referred to found fault with the respective schemes. I acknowledge this but have little to add the findings I made in my provisional decision about the judgments other than I will make a further comment in respect of the judgment involving Hoopla.

I pointed out in my provisional decision that the court didn't agree with HMRC about Hoopla not satisfying the new risk to capital condition, so Sapia's conclusion in 2018 after considering the guidance that it did satisfy the condition was proven to be correct. The rejection by the judge of the appeal by Hoopla was because he found it hadn't complied with a provision of the scheme rules that was in existence well before 2018 and which hadn't led to HMRC questioning Hoopla qualifying as an EIS previously. In the circumstances I don't think that it is reasonable to have expected Sapia to have anticipated in 2018 that HMRC would take issue with it satisfying rules that hadn't stopped it qualifying up to that point.

My final decision

I don't uphold this complaint for the reasons I have set out above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr M to accept or reject my decision before 10 May 2024.

Philip Gibbons
Ombudsman