THE *RAMSAY* PRINCIPLE – WHERE ARE WE NOW?

Patrick Way

Introduction

The Independent recently published a compendium of classic literary works whose plots were summarised in 25 words or fewer and challenged its readers to do better. The readers' attempts at improvement were printed on 14 April 2004 and I will show you some of these efforts in a minute or two. This method of approaching literature is one which I first came across thirty years ago when I bought a pocked-sized book, the title of which I forget, which reduced about 180 great works to a few well chosen paragraphs. But the most attractive feature of that book – now sadly lost – was that it did not stop at telling you what happened in each "oeuvre"; no, it told you what you thought of it. You know the sort of thing: the angst you had gone through when first reading Zola; the fatalistic experience of reading Hardy; the awe-inspiring sadness you felt when you first watched Romeo and Juliet: come on, we've all been there. And this was all particularly useful because you could pop these words of wisdom into conversations at cocktail parties with erudite friends at the moment critique, and hope to impress them.

To give you a flavour of this I have taken three of the readers' summaries from the Independent but I have included the sort of thing which I imagine that that very helpful book from thirty years ago would have added.

Moby Dick – Herman Melville

"Man goes fishing and eventually has a whale of a time. White is definitely not his colour."

"You enjoyed this novel recognising it as firmly at the foundation of American literature. You were swept away by its all subsuming symbolism, the pursuit of the whale being a marvellously evocative representation, of course, of man's tortured ambitions and single-minded aspirations (but you would probably not bother to read it again)."

Macbeth – William Shakespeare

"Scottish megalomaniac urged on by wife, eventually meets his doom because he can't see the trees for the wood."

"You enjoyed the delicious caricature of feminism in the persona of Lady Macbeth alongside the time-honoured image of lily-livered male. You thought Lady Macbeth had her roots in those great English heroines, Boadicea and Elizabeth I and possibly represented a premature brush with Lady Thatcher. You saw the play as yet more evidence of Shakespeare's timeless genius in his observation of the human experience (but you thought all that business of moving forests a little unconvincing)."

> *Ulysses – James Joyce*
>
> "Man ambles round Dublin for hundreds upon hundreds upon hundreds of pages. Nothing happens."
>
> "You found Joyce's stream of consciousness a radical and exhilarating approach to story-telling and although of course you enjoyed every long minute involved in the journey which the narration of necessity entailed you felt, quite frankly, like saying to the author "Less is more, JJ, less is more."

Now I wondered whether it might be possible to apply this sort of summarising approach to some of the tax avoidance cases which you and I have to read from time to time partly because some of the judgments are very long and could benefit from truncating (the *Ensign Tankers* case[1] runs to 134 pages, after all) and partly because I thought (between you and me, dear Reader) that some of those dry old cases could do with livening up.

Before doing so I need to remind you, if you who have been out of the country for a year or so (or ploughing your way through full-length novels) that our understanding of how tax avoidance is viewed by the Courts has enjoyed significant analysis (some might say, "re-analysis") in the recent cases of *MacNiven*[2], *Arrowtown*[3] and *Carreras*[4] and in some talks given by Lord Hoffmann to the International Fiscal Association in the summer of 2003, by Lord Millett on 1 March 2004 to an invited audience at Mishcon de Reya and by Lord Walker on 23 March 2004 to the Chancery Bar Association. In addition we have the *Barclays*[5] and *Scottish Provident*[6] cases to look forward to which are scheduled to be heard by the House of Lords in the autumn of this year.

Where Were We Before *MacNiven*?

Now, I don't know about you, but I think that before *MacNiven* we pretty much knew where we were and there is as good a summary of the *Ramsay*[7] doctrine in *Craven v. White*[8] as anywhere else. Thus Lord Oliver of Aylmerton said at page 203G:-

> "As the law currently stands, the essentials emerging appear to me to be four in number:
>
> (1) that the series of transactions, was at the time when the intermediate transaction was entered into, pre-ordained in order to produce a given result;
>
> (2) that the transaction had no other purpose than tax mitigation;
>
> (3) that there was at that time no practical likelihood that the pre-planned events would not take place in the order ordained, so that the intermediate transaction was not even contemplated practically as having an independent life, and
>
> (4) that the pre-ordained events did in fact take place."

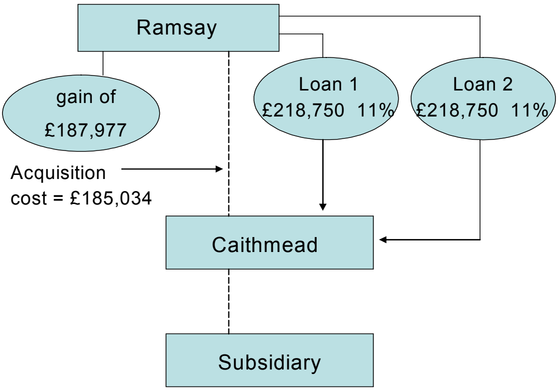
The *Ramsay* scheme, as Lord Wilberforce said, was intricate in detail but simple in its essentials. Ramsay had made a gain of £187,977 and sought to obtain a loss to offset against that gain. It could not afford, of course, to make a "real" (or "commercial") loss and therefore, it had to contrive to make a (tax free) gain of a similar amount as well so that Ramsay was not out of pocket. As an aside, the scheme would probably have failed anyway because the gain which was produced was taxable after all – but that is another story.

Accordingly, Ramsay entered into two loans: one was to produce an indirect loss, and one a gain. Both Loan 1 and Loan 2 were for £218,750 at a rate of 11% interest. It was a term that Loan 1 had to be repaid at par after thirty years and Loan 2 at par after thirty-one years. The loans were made to a company called Caithmead, as part of the overall scheme, and it was provided that the borrower in respect of the loans could repay earlier and would have to repay in any event on its liquidation. On a repayment the sum to be repaid was the higher of the market value or par.

Critically, Ramsay could increase the rate of interest on one loan provided that it decreased the rate of interest on the other loan by the same amount.

The following is a diagrammatic representation:-

HOW DID WE GET HERE?
23RD February 1973



Both loans

- £218,750
- 11%
- Ramsay could increase interest on one loan and reduce the other by the same amount

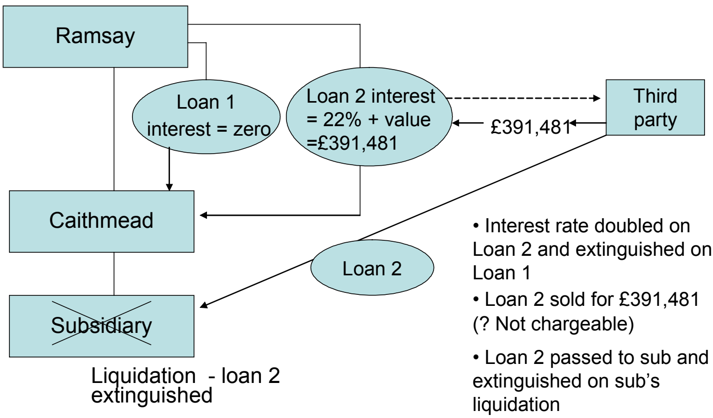
Acquisition cost

- Ramsay paid £185,034 for shares

and that on Loan 1 was cancelled out to zero. This made Loan 2 very valuable, of course, and it was sold to a third party for £391,481 in circumstances where it was contended (unsuccessfully as it turned out) that no gain arose because this was an exempt transaction in respect of a “simple” debt.

The obligation as debtor in relation to the very valuable Loan 2 was then transferred from Caithmead to a subsidiary which was then liquidated resulting in Loan 2 being repaid.

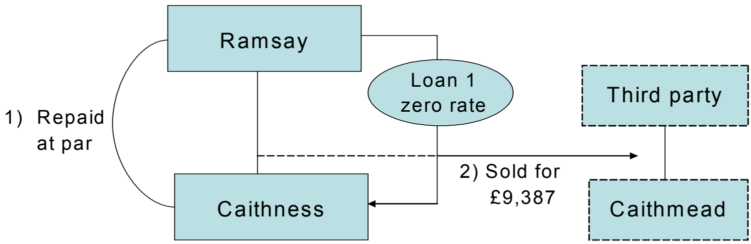
THE DENOUEMENT – loan 2
2nd March 1973



Finally, on the 9th March 1973 Caithmead itself went into liquidation on which event Loan 1 was repayable and was repaid to the appellant.

The shares in Caithmead, however, for which the appellant had paid £185,034 became of little value and the appellant sold them to a third party for £9,287 resulting, so the appellant contended, in a loss of £175,647. That, after all, had been the intention all along.

THE DENOUEMENT – loan 1
9th March 1973



1) Loan 1 repaid at par
2) Caithness sold for £9,387
3) "Loss" of £175,647

So, in a nutshell, the question was (leaving aside the fact that the disposal of Loan 2 was an unintended chargeable event) whether Ramsay could offset its contrived loss of £175,647 against its gain of £187,977.

As Lord Wilberforce said at p.189C/D:

> "On these facts it would be quite wrong, and a faulty analysis, to pick out, and stop at, the one step in the combination which produced the loss, that being entirely dependent upon, and merely a reflection of the gain. The true view, regarding the scheme as a whole, is to find that there was neither gain nor loss, and I so conclude."

He had previously said, at p.187E as follows:

> "To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, there **is not such a loss (or gain) as the legislation is dealing with** (my emphasis), is in my opinion well and indeed essentially within the judicial function."

So even at its inception, the *Ramsay* principle involved considering what the legislation meant, and whether the particular event in question should properly fall within the statute. This is most important.

What *MacNiven* Said

I will set out the facts in *MacNiven* a little later (I am sure you know them anyway). Suffice it to say, at this stage, that a circular routing of money allowed a payment of interest to be made. Did that payment produce a charge on income, under s.338 Taxes Act 1988, as the taxpayer intended; or, did the circularity involved "nullify" matters pursuant to *Ramsay* as the Revenue contended?

Lord Hoffmann confirmed in *MacNiven* that everyone agreed that *Ramsay* was a principle of construction (paragraph [28]) but, at paragraph [56], he referred to Lord Cooke's judgment in *IRC v. McGuckian*[9] where he had said

> "Always one must go back to the discernible intent of the Taxing Act"

So, he picks up what had already been said in *Ramsay*: what does the statute mean? As will be seen later in this article it is this approach, of course, which has allowed the courts to give a purposive analysis of legislation but, it seems to me, that this current imperative based on *Ramsay* itself and owing its origins to the American case of *Helvering v. Gregory*[10] (of which more later) is to see, in deciding what the statute means, whether the transaction in question <u>is the sort of transaction which the statute "has in mind"</u>. This is particularly relevant when the legislation affords a relief or states that a loss arises in other words, where a tax advantage arises. I use the expression "tax advantage" widely not adopting, for example, the definition of that expression found in s.709 Taxes Act 1988. This approach means, in essence, and most importantly, that the courts can determine what they consider to be the facts, or to identify, if you like, what really happened. This, after all, truncates Lord Oliver's four semi-paragraphs above succinctly. More colloquially, one might say:- "Hand on heart, bearing in mind that you are hoping to obtain a tax advantage, does the statute intend you to get away with it and did you really do what you say you did?"

Needless to say, this is put much more eloquently elsewhere. For example, Carnwath LJ said in the *Barclays* case that:

> "… It is difficult to see [*Ramsay*] as a principle of statutory interpretation, in the normal sense. The way in which the House of Lords got over the obvious conceptual hurdles in *Furniss*[11] was, not by reinterpreting the statutory words, but by

> "reconstituting" the facts (to use Lord Oliver's term) … The purposive approach is applied not just to construction of the statute, **but also to the recharacterisation of the facts** (my emphasis)".

If I had to truncate this article then I would do so by reference to these words of Carnwath LJ. This approach seems to me to foreshadow the way in which the *Arrowtown* and *Carreras* decisions, mentioned later, were formulated and also to have its roots firmly in *Ramsay* itself.

In many ways, therefore, the Courts most recently are steering us back to what one might call the original *Ramsay* doctrine and are reducing the relevance of pre-ordination as a test in its own right, are removing the difference between avoidance and mitigation and are putting the dichotomy between juristic and commercial concepts firmly in the background. Let me explain.

Commercial or Legal Concepts

In the immediate aftermath of *MacNiven* most commentators seemed (not unreasonably) to focus on the distinction between commercial concepts and juristic (or legal) concepts which seemed to be the principal feature of that case. Thus if a situation were susceptible to a commercial analysis then, so it seemed, "old style" (or pure) *Ramsay* principles could apply to it (see Lord Oliver above for an indication of pure *Ramsay*): whereas if the concept were purely legal then it was not susceptible to *Ramsay* recharacterisation (you could read the legislation literally). Inevitably this *MacNiven* distinction between commercial and juristic concepts led the Courts to consider, in the immediate aftermath of that case as the principal question in each avoidance case, which concept they were being asked to consider and, not surprisingly, the Courts found this very difficult.

Elsewhere, Lord Templeman[12] dismissed the distinction as "reflecting ingenuity but not principle", Lord Millett described the distinction as "something of a red herring"[13] and Lord Hoffmann said that his judgment in *MacNiven* had been misinterpreted[14].

For what it is worth, I think the distinction still has its uses as I think it assists in certain areas of construction, particularly if one is asked whether a particular act is the sort of transaction that the statute has in mind because it helps the Courts to identify the particular act or transaction and whether that extends to a whole series of steps or something less. In *Ramsay*, as has been seen, there were two equal and opposite transactions, one seeking to produce a tax-free gain and the other a chargeable loss. This strikes me as the paradigm situation where a commercial analysis should be applied: commercially speaking there was neither a gain nor a loss, there was a nullity because you looked at the intertwined features of that scheme as one commercial whole.

Where the distinction is unhelpful, in my view, is because it has been interpreted by others as if certain <u>words</u> are <u>always</u> juristic or commercial, whatever their context. This is patent nonsense. After all, "payment" was juristic in *MacNiven* but commercial in *DTE*[15]. If the concept of juristic:commercial analysis is to have application it must, in my view, be the transaction under review, in its entirety, which is relevant, not a single word.

In *MacNiven* all that was needed to produce the tax advantage sought was for the pension scheme involved to carry out a discrete act of lending and being repaid. Could that circular (but single) transaction still give rise to a tax loss applying the *Ramsay* principle? In *DTE*, however, the whole paraphernalia of what happened was to give employees cash remuneration which was dressed up in the form of trust interests in circumstances where commercially speaking, the reality was that the employers were only ever going to get cash.

However, there is no doubt that the juristic:commercial distinction has been overdone and for the time being, at least, has limited application. Indeed, Lord Hoffmann described *MacNiven* as a "very exceptional" case[15].

Lord Hoffmann did seek, however, in *MacNiven* to put an end to the distinction between acceptable tax mitigation and unacceptable tax avoidance saying that since the statutory provisions did not contain words like "avoidance" or "mitigation" it was unhelpful to introduce them into *Ramsay* arguments ([para.62]). He went on to say:-

> "The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory

> language to the facts of the case. It is not a test for deciding whether it applies or not".

This approach was supported by Lord Hope at paragraph [77] where he said that the issue is one of statutory interpretation which should be approached:

> "without any preconceived notions as to whether this is a case of tax mitigation or tax avoidance"

He also said, I think very importantly, as follows:-

> "The relevant questions are:
>
> (1) the question of law: what is the meaning of the words used by the statute? and
>
> (2) the question of fact: does the transaction, stripped of any steps that are artificial and should be ignored, fall within the meaning of those words?"

So, again, we can see some real threads which remain present three years after *MacNiven* namely:-

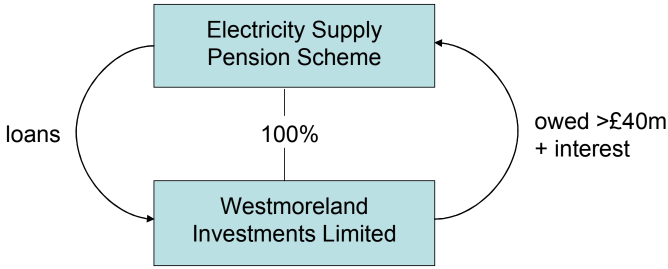
(1) what does the statute mean, and

(2) is this the sort of transaction that the legislation has in mind, and,

(3) what (really) was the transaction to which the statute should be applied?

The facts of *MacNiven*

<u>MACNIVEN v. WESTMORELAND</u>
<u>– starting point</u>



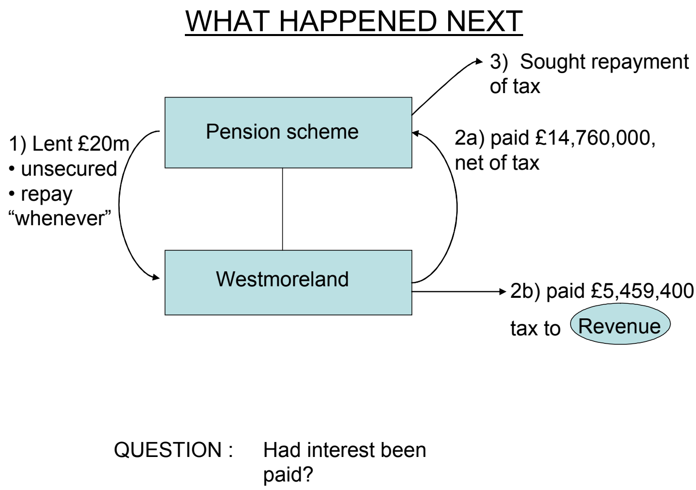
- interest had to be <u>paid</u> to be deductible (s. 338)
- Westmoreland could be sold for £2m as "loss company"

A little late in the day, perhaps, I now look at the facts of *MacNiven*, but I wanted to set out the ground rules involved in the analysis of *MacNiven* before looking at the facts which are quite brief.

In essence, Westmoreland was a property-holding company which had suffered financial difficulties and was loaned substantial amounts of money by its major shareholder which was a pension scheme. The pension scheme wanted to obtain some benefit from the fact that Westmoreland was a loss-making company which could be sold on the market, but in order to crystallise those losses it had to be the case that Westmoreland had actually paid the interest which had accrued on the loans made to it by the pension scheme for the purposes of s.338 Taxes Act 1988.

Accordingly, as the diagram below shows, the pension scheme lent significant amounts of money to Westmoreland which were immediately utilised to pay outstanding interest back to the pension scheme itself and to pay monies on account to the Revenue in relation to which the pension scheme sought repayment.

The Inland Revenue contended that, having regard to the *Ramsay* principle, the interest had not been paid and therefore no charges on income had arisen. The case reached the House of Lords where, as everyone knows, a decision considered at the time to be ground-breaking was given in favour of the taxpayer.



Although Lord Hoffmann is most closely associated with *MacNiven*, it is worth remembering that it was a unanimous decision of all five Law Lords and to my mind, at least, the most helpful learning comes from Lord Nicholls' judgment at paragraphs [15] and [17] where he said:

> "[15] Does it make a difference when the payment [of interest] is made with money borrowed for the purpose from the very person to whom the arrears of interest are owed? In principle, I think not. Leaving aside sham transactions, a debt may be discharged and replaced with another even when the only persons involved are the debtor and the creditor. Once that is accepted, as I think it must be, I do not see it can matter that there was no business purpose other than gaining a tax advantage. A genuine discharge of a genuine debt cannot cease to qualify as a payment for the purpose of s.338 by reason only that it was made solely to secure a tax advantage. There is nothing in the language or context of s.338 to suggest that the purpose for which a payment of interest is made is material.
>
> [17] The feature which makes the … transactions unattractive to the Revenue … is the ability of the pension scheme trustees to reclaim the tax deducted by [Westmoreland] from the payments. But that is the consequence of the tax exempt status of a pension scheme. The concept of payment … cannot vary according to the tax status of the person to whom the interest is owed."

Speaking with the benefit of hindsight, I think that the Revenue were forgetting (when they raised the *Ramsay* doctrine), therefore, that:

(a) the whole structure in question had been in place long before it was sought to take the final step which actually crystallised the loss; and

(b) the only question was: has interest been paid? This question was exclusively juristic in the circumstances and took no account of the fact that no-one became out of pocket when the circular payment had occurred – they were already out of pocket.

Thus, the fact that the "tax" loss was crystallised by steps which <u>at that time</u> produced no commercial loss was not relevant. It would have been different if the scheme had started much earlier but it did not.

Lord Hoffmann's talk

I now consider what Lord Hoffmann said to the International Fiscal Association last year relying as I do on the notes of a member of the audience (for which I am grateful) as I was not there myself.

First, Lord Hoffmann said that there is no question of considering whether there is tax avoidance at the outset when analysing matters and then proceeding on that basis. Tax either attaches to a transaction or it does not. If it does then tax is payable; if it does not then no tax is payable and nothing has been avoided. Those who object to this approach, says Lord Hoffmann, seem to think that there are transactions which "ought" to be subject to tax and that as a result a sort of "judicial bandaid" should be applied to the statute. This according to Lord Hoffmann is an entirely fallacious argument since one cannot know that a transaction ought to be subject to tax. All that one can do is to read the statute.

Secondly, Lord Hoffmann said that his judgment in *MacNiven* had been much misinterpreted, to his dismay, as substituting one solve all magic formula (the "pure" *Ramsay* doctrine) for another (the juristic:commercial concept). Lord Hoffmann had intended this to be a helpful description of situations where a statute taxes an economic event as a whole rather than taking what he described as an atomistic approach and looking at each step separately. (This is why, I have said in this article, that I think it is wrong to attach the juristic: commercial concepts to specific words such as "payment". The approach, if it has any long-term application – which is doubtful – must be in relation to situations as a whole rather than words.)

Then Lord Hoffman went on to say what I think is very interesting. He said that the process of statutory construction is always to some extent a *creative* judicial act. It is not unique to taxing statutes. It involves weighing up the consequences of adopting competing constructions, and deciding which construction best fits:-

(a) the system enacted by the statute;

(b) other statues; and

(c) the common law.

So you cannot look at the statute in blinkers but must look at the overall position.

He took exception to Lord Templeman's attack on his *MacNiven* judgment in the Law Quarterly Review. Lord Templeman had said, apparently, that it could be assumed "with certainty" that Parliament intended that steps with no business purpose except the avoidance of tax should be ignored in ascertaining the tax treatment of a transaction. Lord Hoffmann countered that whilst it might be a good provisional assumption that Parliament intended to tax a transaction, raising that assumption to the status of certainty would wrongly relieve judges of their duty to read the statute itself.

When looking at *MacNiven* itself he said that the clear application of "the pure" *Ramsay* doctrine would have resulted in the entirely circular payments being ignored and the interest not being a "charge on income". However the Lords had decided to take a "harder" look at the statute and had concluded that interest due to a non-bank was only deductible when paid because the interest was only taxable in the hands of the creditor when received i.e. Parliament had provided for symmetry in the system.

Mirroring what Lord Nicholls had said, Lord Hoffmann said that it was a fact that the interest had been paid, the tax had been withheld and was actually paid over to the Revenue. The fact that it could then be recovered because the creditor was a superannuation fund was immaterial. Adopting any other construction of the statute would have distorted the system that Parliament enacted.

Finally, Lord Hoffmann said, without casting doubt on the correctness of the decision in *Pepper v. Hart*[16], that it was not helpful to look at ministerial statements when considering a statute. This is because Parliamentary "intention" is a metaphor that is resorted to when considering a statute and it should be treated as such. To talk of actual Parliamentary intention would imbue Parliament with all sorts of wisdom, knowledge and foresight that it did not possess. Accordingly, he said that *Pepper v. Hart* had fallen out of favour with the judiciary.

Lord Millett's talk

Lord Millett's talk on 1 March 2004 was illuminating and repeated important points from past cases as well as showing how tax avoidance cases may well be viewed by the Courts in the future. Lord Millett first of all took the audience back to the American case of *Helvering v. Gregory* which is a case from 1934 and it is this case which has had a most significant effect on the way in which the *Ramsay* principle has evolved because it plays such an important part in determining how to construe legislation, especially tax legislation.

In *Helvering v. Gregory* a taxpayer had an indirect holding in a target company and sought to avoid tax on a pending sale of the shares in that target company by steps which involved a reorganisation and a liquidation. As a result, the taxpayer claimed to have avoided the gain that would otherwise have arisen on the basis that there had been a previous tax-free reorganisation resulting in an uplifted base cost in the hands of the taxpayer.

The now legendary judge in that case, Judge Learned Hand, considered whether the statutory definition of reorganisation was satisfied in the circumstances to give the relief sought. It was true, he said, that the word "reorganisation" was defined in the statute and that the transaction fell fairly and squarely within that definition but he held that this was not decisive:-

> "It does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition."

He went on to say:-

> "We cannot treat as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to the taxpayer, and her acquisition of the Monitor shares by a winding up of the company. The Averill Corporation had a juristic personality, whatever the reorganisation; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, and their only defect was that **they were not what the statute means by a "reorganization"** (my emphasis) because the transactions were no part of the conduct of the business of either or both companies."

As an aside, in the *Arrowtown* case (dealt with later) Lord Millett said that the transactions in *Helvering v. Gregory* fell outside the statutory definition of reorganisation:

> "…not because they were undertaken in order to avoid tax, but because they had no other purpose. This was a manifestation of a purposive approach to the statutory construction of a tax exemption."

He also referred both in *Arrowtown*, and in his talk, to the Hong Kong case of *Shiu Wing Limited*[17] at which Sir Anthony Mason MPJ had said, at p.240:

> "The Income Tax Act imposes liabilities upon taxpayers based upon their financial transactions, and it is of course true that the payment of the tax is itself a financial transaction. If, however, the taxpayer enters into a transaction but does not appreciably affect his beneficial interest except to reduce his tax, the law will disregard it; for we cannot suppose that it was part of the purpose of the Act to provide an escape from the liabilities that it sought to impose."

In his talk, Lord Millett also said that the particular facts of *Arrowtown* were most unhelpful to the taxpayer because the relative interests of the parties were so extravagant. For example, in that case certain non-voting shares were said to carry 90% of the value of a company called Prepared, whereas the reality was that the shares were virtually valueless. The extravagance which he had in mind was that those shares had a right to a dividend only for a year in which the net profits exceeded HK$1 million billion (said to be a sum larger than the gross national product of the USA) and a right to distribution on a winding up only after the holders of all other shares had received what in the *Arrowtown* case Lord Millett described as the "somewhat more modest distribution" of HK$100,000 billion per share.

Indeed this moved Lord Millett to say, in his talk, that the moral of all this was that if something looked too good to be true then it was or, as he succinctly put it, "Don't be silly". If you take the *NMB*[18] case, said Lord Millett, involving platinum sponges which were to be given to employees as a means of avoiding NICs, you could see that the overall arrangement was simply a cash arrangement because it was pre-arranged that there would be a sale back to the brokers by the employees who received the platinum sponges in circumstances where the reality was that they just received cash. More simply, all that one had to do was to apply the "don't be silly" argument: had the employees received platinum sponges or had they received cash? "Don't be silly – it's clearly cash that is received."

Lord Millett added that it was unfortunate, from his point of view, that Lord Diplock had used the expression "pre-ordained" rather than "pre-conceived" in *Burmah Oil*[19] and it is my observation that it certainly is the case that the pre-ordained test is more onerous than a pre-conceived test would be. After all, in *Pigott v. Staines*[20] Knox J said as follows, at p.372:

> "The fact that there is, at the time of the first transaction, active contemplation or even a better than evens chance of the second transaction taking place is not sufficient if there is a real possibility of a different event taking place.
>
> The fact that the second transaction exactly matches the transaction that was planned at the time of the first transaction cannot be sufficient to bring the totality of the transactions within the Ramsay/Furniss principles if there is, at the time of the first transaction, a real possibility that a different second transaction might be effected. Contemplation of correspondence with an anticipated outcome and probability of occurrence of the second transaction are all insufficient unless it can also be said that the double negative test is satisfied, viz., that there is no real possibility of the particular second transaction not being effective."

It can be seen, therefore, that the approach of pre-ordainment is much narrower than the test of pre-conception would have been, but I consider that the relevance of pre-ordainment has possibly been overdone by the architects of tax schemes. It is not the case that, just because pre-ordainment is avoided, perhaps by long-time gaps, or the use of extraneous and superfluous conditions that a scheme – by that fact alone – "sneaks through".

The principal point which arose from Lord Millett's erudite and cogent talk was, to repeat his "snappy" phrase, that when construing artificial tax avoidance schemes one should at all times adhere to the direction, "Don't be silly".

Lord Walker's talk

Lord Walker's talk on the 23rd March 2004 was an overview of the way in which the *Ramsay* principle has evolved over the last quarter of a century. Much of my record of what he said turns out to be a repetition of many of the points which have already been mentioned in this article (which is not altogether surprising), but by repeating some of these points I am seeking to show again the threads that I think keep appearing in relation to an analysis of *Ramsay*. These seem to me to show that in the recent past the *Ramsay* principle has been pulled back from the place where *MacNiven* took it, and, *MacNiven* can be seen to have been given too much weight in relation to the notion of juristic and commercial concepts.

Thus Lord Walker referred again to the comments which have been expressed by Sir Anthony Mason in *Shiu Wing* that the *Ramsay* principle is concerned both with statutory construction and with the right approach to the analysis of the facts.

Lord Walker then proposed three particular points.

(a) The *Ramsay* principle really is no more and no less than a new <u>and more realistic</u> approach to the construction of taxing statutes (<u>and, as an associated issue, the analysis of the facts to which the statutory provisions have to be applied</u>);

(b) The distinction between tax avoidance and tax mitigation is overdone;

(c) Lord Hoffmann's distinction in *MacNiven* between commercial and legal concepts, although rough and ready and obviously throwing up borderline cases, "is a valuable insight reflecting the varying structure and terminology of taxes, and the variety of avoidance strategies or tactics which may be available".

Interestingly he did refer to the fact that Lord Hoffmann had chosen to illustrate the notion of an entirely legal concept – a conveyance on sale – by referring to the law of stamp duty which Lord Hoffmann seemed to imply was exclusively a juristic matter.

However, Lord Walker cast doubt upon even this canard when he referred to what Vinelott J had said in *Ingram v. IRC*[21] in a judgment which repays careful study.

> "Stamp duty is a tax on instruments. But, in the language of the older cases, to determine whether an instrument falls within a chargeable category and the duty payable, the Court must ascertain the substance of the transaction effected by it. The *Ramsay* principle requires that, in a case where the conditions described by Lord Brightman are satisfied, a composite transaction or series of transactions be treated as a single transaction achieving the pre-ordained end."

In other words, one cannot assume that stamp duty is a purely juristic tax given that it required an analysis of what actually happened: the labels attaching to documents are not conclusive as to their intent.

He also referred to *Helvering v. Gregory* although this was largely to point out that at the time of that decision the United States' Supreme Court was a million miles away from what was said in *Westminster*[22] the American case having been heard only a few months before. He said, as many others have said, that he thought *Westminster* had been wrongly decided and that it was his view that the dissenting judgment of Lord Atkin was on all fours with current thinking.

Indeed, Lord Walker said:

> "The calm and compelling irony of Lord Atkin's dissenting speech (one passage begins, "The embarrassments, however, are not all on the Duke's side" P.514) has to my mind stood the test of time far better than Lord Tomlin's grandiloquent invocation of the "golden and streight mete wand of the law" (p.520).

<u>Pausing there,</u>

So it can be seen, it seems to me, lapsing back into more "laddish prose" as follows.

> "What we're really looking at is a process of construction of the statute and of the facts. Should the Courts look at the facts as they are presented or should they take a "more grown up" view of things in determining what actually happened.

> Having done that the Courts are then entitled to say, "Well, this is not really the sort of transaction which should carry the relief".

The *Arrowtown* Case

The facts in *Arrowtown* were relatively complicated but the issues can be briefly stated. Very valuable land in Hong Kong was to be transferred by an intra-group transaction from Shiu Wing (the eponymous subject of a case already mentioned) to Arrowtown which was an indirect wholly-owned subsidiary of Shiu Wing. Shiu Wing's economic ownership in the relevant sub-structure was then to be sold off to a third party but to avoid Hong Kong stamp duty on the initial intra-group transfer of the land it was intended that effectively valueless shares retained by Shiu Wing in that sub-structure should carry sufficient rights (as to 90% thereof, in effect) such that on any literal reading of the relevant Hong Kong stamp duty legislation that sub-structure remained within Shiu Wing's stamp duty group, thus avoiding the exit charge.

The question arose as to whether the virtually valueless holding of these shares could be said to attract a relief afforded in circumstances where the shares actually carried a 90% interest in the sub-structure.

Ribeiro PJ said the following at paragraph 39:

> "The "valuable insights" that Lord Hoffmann was acknowledging were all centred on the proposition that the *Ramsay* doctrine has at its core the purposive interpretation of statutes

> applied to facts viewed realistically and untrammelled by "limitations" which might be thought to arise out of Lord Brightman's formulation. Such an approach strikes me as the antithesis of a mechanistic use of the "commercial"/"legal" dichotomy as a straightjacket limiting construction of the relevant statute."

The taxpayer lost and the two penultimate paragraphs of Lord Millett's judgment are particularly important:-

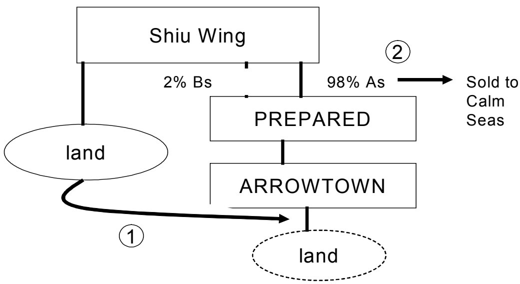
> "[156]. The legislature could have confined relief to the case where the transferor was the beneficial owner of 100% of the issued share capital of the transferee. Had it done so, the present scheme would not have been possible. But the legislature was content with 90%. It must have recognised the commercial need for flexibility in order to permit the holding of small minority stakes without jeopardising the relief. But the legislature cannot have intended the 10% allowance to outsiders to be exploited so as to permit relief to be available in a case where the property was, to all intents and purposes, transferred to a 98% owner with the transferor retaining only 2% even if the literal requirements for exemption were complied with.
>
> [157] Section 45 is not an end in itself. The words "issued share capital" in the section, properly construed, mean share capital issued for a commercial purpose and not merely to enable the taxpayer to claim that the requirements of the section had been complied with. It follows that the "B" non-voting shares issued to Shiu Wing are not "share capital" within the meaning of the

section, and it should be disregarded when calculating the proportions of the nominal share capital owed by Shiu Wing and Calm Seas respectively."

The following is a diagrammatic representation:-

ARROWTOWN

(Truncated Structure)



Did "2%" Bs carry 90% rights

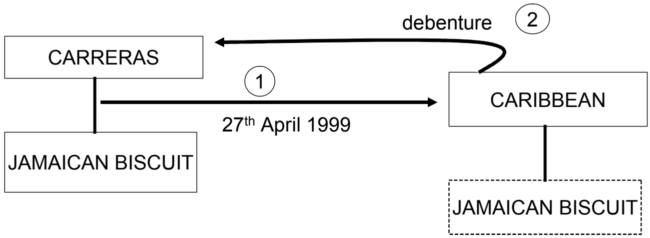
"Share capital means shares issued for commercial purposes therefore these Bs are not share capital"

The *Carreras* case

The facts in *Carreras* can be represented by the following diagram.

CARRERAS

(Transfer tax copied 1965 capital gains tax legislation)



Sale for debenture = exempt

Sale for cash = chargeable

The case was heard by the Privy Council earlier this year and such is the clarity of Lord Hoffmann's wording that I can set out the facts from the first three paragraphs of his judgment in that case.

> "1. On 27 April 1999 Carreras Group Ltd ("Carreras") entered into a written agreement to transfer all the issued ordinary share capital and most of the preference shares in Jamaica Biscuit Company Ltd ("Jamaica Biscuit") to Caribbean Brands Ltd ("Caribbean"). The consideration was expressed to be a debenture to be issued by Caribbean in the sum of US$37.7 million and in terms annexed to the agreement. The terms were that the debenture would not be either secured or transferable. The principal debt would carry no

> interest and be repayable by banker's cheque on 7 May 1999.
>
> 2. In the event, the debenture was not redeemed until 11 May 1999, when Caribbean paid US$19.9 million and J$700,344.814 and Carreras accepted these payments in full settlement.
>
> 3. The question in this appeal is whether the transfer of shares is chargeable to transfer tax."

The point was that the Jamaican transfer tax legislation had copied the 1965 Capital Gains Tax legislation so that there was the equivalent of what is now s.135 TCGA 1992 (share for debenture exchange – exempt) and s.251 (disposal of a debt – exempt). Putting these two sections together it could be argued that there had been a tax-free reorganisation producing a debt followed by a tax-free disposal of that debt when the debenture was redeemed.

The obvious problem with the Jamaican legislation was that it did not keep track of the UK legislation and did not have the equivalent of s.137 TCGA 1992 which, of course, denies reorganisation relief where it is tax-driven. So, was the transaction tax-free?

Paragraphs 6, 7 and 8 of the judgment repay close reading and are set out below with my added emphasis:

> "6. Carreras says that if one reads the agreement of 27 April 1999, it falls squarely within these exempting provisions. The issue of the debenture by Caribbean in exchange for the

original shares held by Carreras in Jamaica Biscuit was required to be treated as if Caribbean and Jamaica Biscuit were the same company and the exchange was a reorganisation of its share capital. By virtue of paragraph 4(2), it was therefore not to be treated as involving any disposal of the Jamaica Biscuit shares.

7. Their Lordships agree that the question is whether the relevant transaction can be characterised as a reorganisation of share capital as defined in the Act. That is to say, as a debenture in exchange for shares. They also accept that if the relevant transaction is confined to what happened on 27 April by virtue of the agreement executed on that date, there can be no doubt that it fell within that description. **On the other hand, if one is allowed to take a wider view and to treat the terms of the debenture and its redemption two weeks later as part of the relevant transaction, it looks very different**. (my emphasis) From this perspective, the debenture is only a formal step, having no apparent commercial purpose or significance, in a transaction by which the shares in Jamaica Biscuit were exchanged for money.

8. **Whether the statute is concerned with a single step or a broader view of the acts of the parties depends upon the construction of the language in its context**. (my emphasis) Sometimes the conclusion that the statute is concerned with the character of a particular act is inescapable: see *MacNiven (HM Inspector of Taxes) v Westmoreland Investments Ltd* [2003] 1 AC 311. But ever since *Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 the courts have tended to assume that revenue statutes in particular are concerned with the

> characterisation of the entirety of transactions which have a commercial unity rather than the individual steps into which such transactions may be divided. This approach does not deny the existence or legality of the individual steps but may deprive them of significance for the purposes of the characterisation required by the statute. This has been said so often that citation of authority since *Ramsay's* case is unnecessary."

So, it can be seen that *Carreras* is telling us to look and see what act or transaction is relevant and so encapsulates all that has been said about the *Ramsay* principle (see especially Lord Oliver's analysis earlier) but truncates the thinking most succinctly and with great clarity. *Carreras* is a very important decision.

Now, dear Reader, you know the outcome of *Carreras* of course, but put yourself in the position of the taxpayer. If one looks at *MacNiven*, things happened very quickly there and the money went round in a circle but one applied a juristic approach and said (albeit for the reasons that are mentioned in this article) that in reality there had been the appropriate payment. Now, if one is going to apply a juristic formulation, is it not possible that you simply say, well, there was a debenture and it does not matter whether the debenture lasted for a year, half a year, one month or one minute; there either was or was not a debenture. This, after all, is a juristic concept, so you argue, at least. If, then, as a further juristic matter, the debenture is redeemed does not that just simply mean that you follow the paper trail which takes you through the two exemptions in the legislation and you say "No tax". This, after all, seemed a wholly justifiable and worthwhile argument at the time the Privy Council heard the *Carreras* case.

Answer, I am afraid: "Don't be silly" or, a little more fully, "You are missing the point" because the real point is that *Ramsay* allows the Courts not just to construe the legislation but also to construe the facts and the Courts say that there was one single transaction and that transaction taking account of all that they heard and saw (and, frankly, did not hear and see) was that it was always intended that the vendors would receive cash. Of, if you like, *MacNiven* could focus just on the act of loan and repayment because that was the relevant matter for analysis; whereas in *Carreras* the whole process of payment, including the issue of the debenture, was susceptible to *Ramsay*. Put it another way, identify the first step in the avoidance and apply *Ramsay* from that event onwards.

It is worth setting out paragraphs 15 and 16 of the judgment.

> "15. [The taxpayer] submitted that a factual inquiry into what constituted the relevant transaction … would give rise to uncertainty. He was disposed to accept that if the representative of Carreras had handed the share certificates over the desk in exchange for the debenture and the representative of Caribbean had then handed it back in exchange for a cheque, it would be hard to say that the relevant transaction should not be characterised as an exchange of shares for money. But what if the debenture had been redeemed a year later? Why should a fortnight be insufficient to separate the exchange from the redemption?

> 16. One answer is that it is plain from the terms of the debenture and the timetable that the redemption was not merely contemplated (the redemption of any debenture may be said to be contemplated) but intended by the parties as an integral part of the transaction separated from the exchange by a shorter time as was thought to be decent in the circumstances. The absence of security and interest reinforces this inference. No other explanation has been offered. In any case, Their Lordships think that it is inherent in the process of construction that one will have to decide as a question of fact whether a given act was or was not a part of the transaction contemplated by the statute. In practice, any uncertainty is likely to be confined to transactions into which steps have been inserted without any commercial purpose. Such uncertainty is something which the architects of such schemes have to accept."

So one can see in *Carreras* what has been evident throughout this article. *Ramsay*:-

(a) is a question of construction of the legislation,

(b) is a question of construction of the facts,

(c) is an identification of which act or transaction (if any) must be submitted to *Ramsay* analysis, and

(d) means that the Courts have to do their best and if there is some element of uncertainty which might produce a "tough" decision

> then that is the risk which the tax avoiders have to take.

Thus it can be seen that Lord Hoffmann's judgment in *Carreras* gives a mature and intelligent analysis of *Ramsay* shorn of all the imperfections of earlier court judgments which have been taken us on wild goose chases and up blind alleys. It is the *Ramsay* principle distilled to its unblemished essence.

Barclays* and *Scottish Provident

There are two big cases coming up in the House of Lords which are the *Barclays* case and *Scottish Provident*. All that one can say is that these cases, it is to be hoped, will throw yet more light on to the way in which the *Ramsay* principle is developing post-*MacNiven*. I think it is difficult to pre-judge the outcome but I hope the judgments will be as elegant and comprehensible as in *Carreras*.

The Student's Guide

Now, dear Reader, if you have a long memory you will recall that at the beginning of this article I copied out the Independent's summary of three literary works and then added my, very flippant, comments as to what you thought of them so that you could drop this into the conversation when appropriate. Heaven help you!

So let's finish off by looking at some of the tax cases that have been mentioned in this article, in the style of the Independent's summary.

The Duke of Westminster Case

“The Duke got away with an early form of remuneration planning.”

You say “Antediluvian tax case, especially that bit about the “golden and streight mete wand”. You had thought Lord Atkin’s dissenting judgment to be correct for a long time and are glad to see the rest of the world catching up.”

Pepper v. Hart

“Some schoolteachers at a fee-paying school got pretty much tax-free education for their kids because of a ministerial statement in Parliament to that effect.”

“You say that you think the case was a one-off. Very much out of favour now and quite frankly you’re surprised it’s still mentioned outside academic circles.”

MacNiven v. Westmoreland

“Circular payments were OK because the juristic concept prevailed and did not allow *Ramsay* recharacterisation.”

“You have had to change tack on this. Three years ago you would have said that *MacNiven* represented a dramatic new analysis of *Ramsay*, and cases from then on would turn on the critical juristic: commercial dichotomy; six months ago you denied ever having said that bit about juristic:commercial dichotomy and would have said that the case was highly exceptional and unlikely to be repeated; now you think the case may possibly have some relevance but you're not really sure."

Helvering v. Gregory

"An attempt at a tax-free reorganisation failed because it was not what the statute had in mind."

"You think this is <u>the</u> seminal case on tax avoidance and you keep a copy of it with you at all times, even by your bedside. As for that Judge Learned Hand, in your opinion he was the brightest man of his generation and your American cousins almost certainly knew him."

Carreras

"In a judgment which crystallised and clarified *Ramsay* thinking, the relevant act was held to be nothing more or less than a cash transaction."

"You, dear Reader, when *Carreras* is mentioned, appreciate that this case is the contemporary distillation of *Ramsay* but you say nothing and just smile knowingly (until the next case comes along, that is!)."

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1 *Ensign Tankers (Leasing) v. Stokes* HL 1992, 64 TC 617.
2 *MacNiven v. Westmoreland Investments Ltd* HC 2001, 73 TC 1.
3 *Collector of Stamp Revenue v. Arrowtown Assets Limited* FACV No.4 of 2003.
4 *Carreras Group v. SC* PC No.24 of 2003.
5 *Barclays Mercantile Business Finance Ltd v. Mawson* (2003) CA, [2003] STC 66.
6 *IRC v. Scottish Provident Institution* (2003) CA, [2003] STC 1035.
7 *Ramsay v. IRC*]1981] STC 174.
8 *Craven v. White* HL 1988, 62 TC 1.
9 *IRC v. McGuckian* HL 1997, 69 TC 1.
10 *Helvering v. Gregory* (1934) 69 F. 2d 809, (1935) 293 VS 460.
11 *Furniss v. Dawson* [1984] STC 153.
12 *Law Quarterly Review* (117 LQR at 582).
13 Mishcon de Reya talk, 1st February 2004.
14 The International Fiscal Association in June 2003.
15 *DTE Financial Services Ltd v. Wilson* CA 2001 (74 TC 14)
16 *Pepper v. Hart & Others* HL 1992, 54 TC 421.
17 *Shiu Wing Ltd v. Commissioner of Estate Duty* (2000) 3 HKCFAR 215.
18 *NMB Holdings Limited v. Sec. of State for Social Security* QB 2000, 73 TC 81.
19 *CIR v. Burmah Oil Co Ltd* HL 1987, 54 TC 200.
20 *Pigott v. Staines Investments Ltd* Ch.D 1998, 68 TC 342.
21 *Ingram v. IRC* 1985 Ch.D, [1985] STC 835.
22 *Duke of Westminster v. IRC* HL 1935, 19 TC 490.