

WORDS FROM THE HEART:

TAX AVOIDANCE OF THE THIRD KIND; THE LESSONS OF SCHRODINGER'S CAT

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INTRODUCTION AND BASIC THESIS

Does time exist? Is this table solid? The physicist Richard Feynman once said that, if all knowledge were to be destroyed but for one piece of information which could be passed on to future generations, the most important thing we could tell them is that everything in the world is made up of smaller things. So a table which seems to us solid is, in fact, a mass of atoms whizzing around in constant movement, giving only the appearance of solidity. And, inside each atom, there are smaller particles, electrons and neutrons, certainly quarks and, perhaps, Higgs bosons. And, although nobody yet knows if there really is a Higgs boson or if it is only a figment of a physicist's imagination, all these things help to explain the nature of the universe.

But something odd happens when you examine what goes on inside an atom. Although scientists can predict with certainty where an electron will be at a particular moment they cannot say at all how it gets there. The reason is that an electron seems to do something different when a scientist – or anyone else for that matter – looks at it from that which it does when it isn't being looked at. The understanding that this was so was developed by the German physicist Werner Heisenberg and his theories about this are called the uncertainty principle. Heisenberg's fellow physicist, Schrodinger, produced an example of how the uncertainty principle applied by relating it to a cat. The cat appears in the title of this talk and I shall have more to say of it later.

Now, most of you are probably expecting to read an article on recent developments in the case law concerning tax avoidance, and some of you may be wondering what physics has to do with the

topic. The branch of physics I have been talking about, the branch that deals with the way in which sub-atomic particles work, is called quantum physics and, though I may be wrong, I rather think the expression “quantum leap” is taken from this branch of physics and relates to the way in which particles do unexpected things when they are looked at.

My thesis is that, in the two recent cases of Arrowtown and Carreras, the judges of different jurisdictions have taken a quantum leap and dealt with tax avoidance of a kind different from that which has arisen in earlier tax cases by applying something which, in legal terms, is akin to Heisenberg’s uncertainty principle. This is in part because, to jump ahead to my conclusion, both Arrowtown and Carreras involve examining minutely one particular part of a structure: shares in the case of Arrowtown and a debenture in the case of Carreras. Upon examination of these choses in action by the courts, it appears that they lose the quality of “shareness” and “debentureness” which, it is admitted, they have when they are not being examined by the courts. It seemed to me, even before I saw Lord Hoffmann’s judgement in Carreras, that this was rather akin to the way in which an electron behaves differently when it is looked at by scientists. My feeling that this was so was reinforced by Lord Hoffmann’s reference to uncertainty in Carreras, by his contrast there between the entirety of a transaction and its individual steps and by noting, from his speech in Kleinwort Benson, that he, too, is interested in Schrodinger’s cat. So my feeling is that in tax avoidance cases, the courts are applying principles derived from or akin to the principles of quantum physics rather than notions derived from plain and common sense, which is what they would like us to think they are applying.

In Arrowtown and Carreras the courts have struck down tax planning which was not dependent upon analysis of a transaction but was, rather, dependent on the quality of a particular instrument. In Arrowtown the court has said that shares, although shares, were not the sort of shares referred to in the relevant legislation. And in Carreras the existence of a debenture has been ignored, even though it is admitted that it was issued. For my own part I find the logical, as distinct from the factual, basis for this decision hard to follow;

but it is clear that the issue of the debenture was treated as not relevant even though the legislation refers to an issue of a debenture. In doing this, courts which derive their authority directly or by inheritance from the imperial tradition (the Court of Final Appeal in Hong Kong and the Privy Council) have gone further than any of the previous decisions on tax planning have gone in similar jurisdictions or, indeed, I suggest, in the United States of America. As I shall endeavour to show, all of the previous decisions in this area of the law have concerned questions about transactions and what transactions achieved. Thus there have been cases about circular self-cancelling transactions and there have been cases about linear transactions. But all the cases until *Arrowtown* and *Carreras* asked questions about transactions. *Arrowtown* and *Carreras* are different because, as I have said, they do not ask active questions about transactions, but static questions about the nature and quality of instruments, and they may have introduced a general business purpose test applicable to all cases in which a claim to a tax relief is made. At any rate, they have changed and broadened the Ramsay approach.

And this is why I have given this article the title of Tax Avoidance of the Third Kind: it is because the static qualitative questions which arose in *Arrowtown* and *Carreras* and the decisions in them are radically different from the issues which arose and were decided in the earlier cases, which raised much more mobile or factual questions.¹ In order to demonstrate that this is so, and also to explain with some accuracy what has happened in *Arrowtown* and *Carreras*, it is necessary to survey the history of how the Ramsay line of cases has developed.

¹ The description of *Arrowtown* and *Carreras* as tax avoidance of the third kind is also a reference, in part, to a speech recently given by Lord Walker to the Chancery Bar Association in which he referred to a paper he had given about 20 years ago called Seven Types of Tax Avoidance. He labelled the 7 types of tax avoidance something like this: "(1) using a relief; (2) finding a gap; (3) exploiting (or abusing) a relief; (4) anti-avoidance karate; (5) unnatural assets or transactions; (6) pre-ordained transactions; (7) dodgy offshore schemes." I suppose *Arrowtown* and *Carreras* might fall in to the third or fifth of Lord Walker's categories.

HISTORY

I shall do that rather briefly here from the origins of judicial anti-avoidance to MacNiven; I shall then state the principles to be extracted from the English and Hong Kong case law as it stood just after MacNiven, and then I shall look to see whether Arrowtown and Carreras have changed those principles.

I think the period up to and including MacNiven can be divided into eight parts:-

1. Origins
2. Importation
3. After-Shock
4. Development
5. Retrenchment
6. Expansion
7. Export
8. Review

Origins

There was not really perceived to be a problem with tax avoidance in the United Kingdom until well after the end of the First World War and I do not think judges here were concerned about what is – wrongly, but often – called “the problem of tax avoidance” until the 1960’s. The well-known case of the Duke of Westminster may be seen as demonstrating a certain insouciance among UK judges about tax avoidance. There is certainly no suggestion in that case that tax avoidance required any special rule to be applied to it: indeed, the contrary was asserted.

The position was different in the United States of America. I believe that judicial activity against tax avoidance can be found there as early as the 1920’s, but Lord Millett, who is, of course, the

father of the Ramsay doctrine in the United Kingdom, in rather the same way as Edward Teller is regarded as the father of the hydrogen bomb in America, has placed first in his pantheon of anti-tax avoidance heroes, Judge Learned Hand of the New York Circuit Court of Appeals, who was active in this field in the mid-1930's. There is some misunderstanding about the history of Judge Learned Hand. Some people think he was of Red Indian origin and others Dutch: the issue arises because of his extraordinarily charismatic name. In fact, however, Judge Hand came from solid American stock with the odd habit of using, as the first names of later generations, the surnames of earlier generations. Judge Hand's real name was Billings Learned Hand. This was because, among his ancestors in the maternal lines, there were a Mr and Mrs Billings and a Mr and Mrs Learned. Young Hand did not like the name Billings very much so he quietly dropped it and so gave himself this incredibly charismatic name. He was, of course, fortunate that his surname was Hand. Had it been Foot the name might not have seemed so charismatic. Hand, who is very highly regarded as a common law judge, began his working career as a provincial lawyer and soon moved to New York to practise. However, for whatever reason, he was not happy as a practising lawyer and was not earning as much as he would have liked, so, after a very short period as a working attorney, he became a judge.

In 1934, about a year before the House of Lords decided Duke of Westminster, Judge Learned Hand decided a case called Helvering v. Gregory. Mrs Gregory owned all the shares in a company called the United Mortgage Corporation – UMC. UMC owned all the shares in another company – Monitor. UMC could have sold Monitor and paid a dividend to Mrs Gregory. If that had happened, there would have been income tax to pay on the dividend. However, there was a relief for re-organisations of companies and so what Mrs Gregory did was this. She formed a new company called Averill. UMC then transferred all the shares in Monitor to Averill and, in return, Averill issued shares to Mrs Gregory. Pausing here, the transaction is exactly that which we do in this country when we make an exempt distribution in the form of a re-organisation. It is thus similar to a s.110 reconstruction except that the transferor company remains in existence. Averill – the acquiring company –

was then wound up and the shares in Monitor were transferred to Mrs Gregory in the winding up.

It seems that there was no dispute about the consequences of winding up Averill: at any rate there is not much debate about that in the case. The question at issue seems to have related to the tax consequences for Mrs Gregory of UMC's transfer to Averill in return for an issue of Averill shares to Mrs Gregory. It seems that, if the issue of Averill shares to Mrs Gregory was "in pursuance of a plan of reorganisation" there was no tax to pay on it for anybody. It was accepted on all sides in *Helvering v. Gregory* that what occurred fell within the literal wording of the relieving provision. I should perhaps say now, in view of what I am going to say later, that I find it difficult to see why what happened in this case did fall within the literal meaning of the relieving provision. It seems to me, looking at the wording of the provision, that it is at least arguable that it did not. But nobody argued that in America in the 1930's and so we must take the case as one where the actual words of the relieving provision were satisfied.

The Revenue argued, in effect, that all the tax planning was a nullity so that this was a case of UMC paying a dividend and nothing else. The Courts rejected that approach. However, it turned out that the relief was still not available. Judge Learned Hand said this:

"Nevertheless, 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. It is quite true, as the Board has very well said, that as the articulation of a statute increases, the room for interpretation must contract; but the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate recourse to the setting in which all appear, and which all collectively create. The purpose of the section is plain enough; men engaged in enterprises – industrial, commercial, financial, or any other – might wish to consolidate, or divide, to add to, or subtract from, their holdings. Such transactions were not to be considered as "realising" any profit, because the collective interests still remained in solution. But the underlying presupposition is plain that the readjustment shall be undertaken for reasons germane to the conduct of the venture in hand, not as

an ephemeral incident, egregious to its prosecution. To dodge the shareholders' taxes is not one of the transactions contemplated as corporate "reorganisations".

And then he went on to conclude:

"We do not indeed agree fully with the way in which the Commissioner treated the transaction; 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 winding up that company. The Averill Corporation had a juristic personality, whatever the purpose of its organisation; 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 "reorganisation" because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect."

I should, perhaps, comment on Judge Learned Hand's reference to a melody being more than notes. My reading about Judge Learned Hand tells me that he was thrown out of his Glee Club while at university for not being able to sing; and it may be that his inability to sing is reflected in an inability fairly to construe statutes. It is very hard to see why the reconstruction which took place in *Helvering v. Gregory* – assuming it indeed to satisfy the literal words of the statute – is not the reconstruction meant by the definition of "reorganisation" in the American statute. I might say that I have read all of the relevant provisions in the US Code to see if I, as an objective outside observer, could divine some purpose of the legislation which would support the conclusion in *Helvering v. Gregory*. My reading is necessarily not as deep as that of someone steeped in US tax law but, my own view, reading the provisions in context, was that their purpose was to facilitate all forms of reconstruction so that no limitation by reference to commercial desirability or business purpose could be read into them.

It is important to notice what an insidious little worm has here been planted into the apple of statutory construction. What was done was the very thing to which the statute refers, but it is not what the

statute means. How does a judge know what the statute means except by reference to what it says? The answer might be – there will be something more of this later – by looking to the purpose of the legislation. But, again, how does a judge know what the purpose of legislation is, except by looking at the words of the statute? And, if the words of the statute do not mean what they say, what do they mean? These questions do not appear to have caused much concern in America. At any rate, in America the Courts went on to develop all sorts of tests – the step doctrine, the no business purpose doctrine, the substance over form rule and the economic reality test – all designed to see whether what happened in a case was the thing that the statute was meant to refer to.

Three things may be observed at this stage. First, these developments go on to this day. Secondly, while the tests purport to be concerned with ascertaining the true meaning of a statute, they are all heavily concerned with analysing the facts of a case. Thirdly, these are all rules which seem to apply where cases of tax avoidance are concerned and they do not necessarily apply in other cases.

I think we can leave America for the time being and come here. Before I do so, however, I should note that in some judicial quarters, *Helvering v. Gregory* has been elevated to iconic status, even though, as I have attempted to show, it is difficult to follow and probably wrong at least through UK eyes. I think its talismanic status is a shame. *Helvering v. Gregory* can only be given that sort of status if a moralist approach is taken to tax avoidance and, as I shall argue later, it should not be.

Importation

The *Duke of Westminster*'s case was widely regarded as setting out unchangeably in stone a rule that regard had to be had to form and not to substance. This is wholly to misunderstand what the case actually decided. It is sometimes said that a case is not important for what it decides, but only for what it is believed to decide, so that the myth is the message. But this is wrong – and badly wrong: in a system that depends on the rule of law to uphold its values a case is, or should be, authority only for what it actually

decides. The question of law in the *Duke of Westminster* case was whether the Duke was paying an annuity or not. The question of fact which arose was whether the Duke was making a payment in return for work under a contractual obligation, a question which could only be answered by close consideration of the arrangements he had made with the recipients of the annuities. The Commissioners had found that there was no contractual arrangement between the Duke and the annuitants. No doubt one can quibble with the conclusion of the Commissioners: it is often possible that facts are capable of more than one interpretation. But once it is accepted that there was no contract in the Duke's case, the conclusion that he was paying an annuity was inevitable. Accordingly, even if we had, in the 1930's, adopted here in the United Kingdom the same approach as Judge Hand adopted in *Helvering v. Gregory*, the conclusion in the *Duke of Westminster*'s case would or should have remained the same: the Duke was paying an annuity. On a true analysis – and it really did not need any new case law to tell us this, only a reading of the *Duke of Westminster* case itself – the *Duke of Westminster*'s case is not in any way a bar to anything which follows.

This, then, was the position in the United Kingdom when, in the 1970's and early 1980's, the burgeoning tax avoidance industry began to sell tax avoidance schemes as if they were soap powder in a supermarket. Up until then the sort of tax avoidance which went on in this country had been very much of the bespoke sort, individually tailored to the demands of a particular taxpayer. But in the 1970's and 1980's mass-produced products were sold more or less on a one-size-fits-all basis to anybody with the money and appetite to buy one. Each of these schemes typically came with a guarantee of free litigation. Purchasers tended to assume that the guarantee was that, if there were litigation, it would be free. Unfortunately, however, matters turned out so that the guarantee was, actually, a guarantee that there would be litigation and all of these schemes ended up in court.

The first and, perhaps, most famous of these schemes was the loss-creating scheme in *Ramsay*² and it was in the this case that

² [1982] AC 300

Peter Millett QC, as he then was, introduced the House of Lords to Judge Hand's judgement in *Helvering v. Gregory*. It is to be noted that the House of Lords did not expressly adopt anything said by Judge Hand in that case. In fact they did not mention it at all, referring to two other US cases, not as authority but only as examples of a process of thought³. The House of Lords dealt with *Ramsay* as if it raised an ordinary question of statutory construction and, in doing that, they were correct. The question which arose was whether there was a loss for the purposes of capital gains tax. That is a question of statutory construction and the only issue which arises is whether the House of Lords handled the factual aspects of the question fairly. In order to answer the question which arises in *Ramsay*, it is necessary to see whether the taxpayer actually did realise a loss and there can, I think, be two views on that. The House of Lords, however, took a compendious view of the facts and regarded the taxpayer as not realising a loss which was, of course, taking the matter as a whole, true. Nonetheless, the decision created shock waves in the tax world which, as it seems to me, looking back on it now, must have been living before then in the Elysian fields of a lost paradise. However, the matter was soon rationalised on the basis that the decision applied only to circular self-cancelling transactions. On that comfortable view, all that *Ramsay* decided was that, where there were circular self-cancelling transactions, the transactions could be ignored. I have called this phase "importation", even though it can be seen that we did not actually import all of the doctrines or even part of the doctrines current in the USA. But I think it fair to call this phase importation because there is no doubt that the *Ramsay* decision was, at least in part, influenced by the thought that American judges, and Judge Hand in particular, had apparently been doing more inventive and exciting things in the USA in relation to tax planning than judges here had been doing. The popular mood being against tax planning,⁴ judges here thought it was time to jump on the bandwagon.

³ [1982] AC 300 at 326/7.

⁴ Compare the Inland Revenue Press Release of 3 May 2003: *International action to tackle tax avoidance industry* [2004] STI 1139.

After-Shock

The *Ramsay* case had not been long decided before the House of Lords decided *Burmah Oil*⁵. As I shall show in a moment this case was in fact a decision based on very orthodox techniques of statutory construction. But the speeches in the House of Lords gave it the appearance of a more radical application of *Ramsay*. If *Ramsay* had been the equivalent of an earthquake, *Burmah Oil* was an after shock, perhaps of greater severity than the original earthquake. But at least the talk was still of circular transactions.

Development

The hope that *Ramsay* was confined to circular self-cancelling transactions was short-lived. In *Furniss v. Dawson*⁶ the House of Lords extended the *Ramsay* principle from circular transactions to linear transactions so that steps inserted in a linear transaction with no commercial purpose other than tax avoidance as part of a pre-ordained scheme could be ignored. This decision was, again, a further shock to the tax world but it did at least seem to lay down a set of conditions which had to be satisfied before the so-called new doctrine could be applied.

Retrenchment

The view that there was a hard and fast set of circumstances which had to exist before the so-called new doctrine could be applied was apparently confirmed by the decision in *Craven v. White*⁷. In that case Lord Oliver says at page 514 F to H.

“As the law currently stands, the essentials emerging from *Furniss v. Dawson* [1984] AC 474 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 that transaction had no other purpose than tax mitigation; (3) that there was at that time no

⁵ [1982] STC 30.

⁶ [1984] AC 474.

⁷ [1989] AC 398.

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. In these circumstances the court can be justified in linking the beginning with the end so as to make a single composite whole to which the fiscal results of the single composite whole are to be applied.”

At this stage we were all able, as it were, to pause for breath and say “Well, we have a doctrine with rules and we know what the rules are so this is a doctrine with which we can live and work”. It does, however, have to be remembered that there were very clearly two very different schools of thought in the House of Lords at this time. There were proponents of a very loose and broad doctrine of judicial anti-avoidance, chief amongst whom was Lord Templeman; and there were other judges who were in favour of a narrow set of rules, being the rules set out by Lord Oliver in Craven v. White, and the chief proponent of those rules was, of course, Lord Oliver himself. Those mortals amongst us who have to work with and operate the tax system were left watching this battle taking place, as it might be, on the Olympian heights of the House Of Lords with some interest and in the hope that the narrow doctrine would be the winner. However appealing it may be to a judge to arrogate flexible doctrines to himself, a tax system needs some degree of certainty and, without it, it becomes both unfair and inoperable: the narrow view needed to be the winner. It is to be noted also that in Craven v. White the argument for some of the taxpayers was that the Ramsay doctrine is concerned only with an analysis of the facts. However, all the judges in the House of Lords assert that the doctrine is based on statutory construction and that all that the judges are doing in Ramsay cases is interpreting the statute.

Expansion

The hope that the narrow view would be the winner was a little disturbed by the decision in McGuckian⁸. A possible reading of that decision was that it permitted a re-characterisation of a capital

⁸ [1997] 1 WLR 991

receipt as income. I shall endeavour to show in a moment that that is not what the case actually decided, but there were some concerns that it represented a departure from the view carefully explained by Lord Oliver in Craven v. White.

Export

There are actually not many jurisdictions outside the United Kingdom which are interested in what we call the Ramsay principle. Australian courts have a general anti-avoidance rule to play with and are not desperately interested in – although they note in passing – Ramsay. And the courts in the USA are so deeply involved with their own elaborate doctrines in this field that they are not in the slightest bit interested in Ramsay.

But in Hong Kong the Courts have been interested in Ramsay, and they first adopted the Ramsay approach as part of Hong Kong jurisprudence in a case called Shiu Wing Steel⁹ which was decided by the Court of Final Appeal in Hong Kong. The Court of Final Appeal in Hong Kong is a most interesting tribunal because it is composed partly of judges whose experience is entirely or, at least, mainly in Hong Kong and judges from other commonwealth jurisdictions. The court is thus interested in an unusually wide range of authorities from different jurisdictions which are then examined objectively by judges who were not involved in making the decisions in those cases. It may be that a more objective view of case law can be obtained in that way. At any rate, in Shiu Wing Steel, the leading judgement was given by Sir Anthony Mason, a former Australian Chief Justice, who reviewed most of the Ramsay cases decided up until that time.

Although, as I have indicated, UK courts had been protesting that all they were doing was interpreting the statute, Sir Anthony Mason says that the Ramsay approach is both an approach to interpreting the statute and an approach to the facts. I think that Shiu Wing Steel is the first case to suggest that, no matter what they are saying, the judges in our Ramsay cases have been adopting an

⁹ [2000] HKCFA.

approach to the facts since Ramsay which is different from the sort of approach they were adopting before Ramsay. Whether this suggestion is right or wrong we shall, perhaps, be able to decide by the end of this talk. However, no matter whether it is right or wrong, the point to note here is that, by 2000, at least one jurisdiction outside the United Kingdom had adopted the so-called Ramsay principle as part of its jurisprudence.

Review

So, by 2000 we had had a number of decisions related to the field of tax avoidance, covering really quite a wide range of questions and all referring to Ramsay. But what did these cases actually decide? In essence every tax case ought to raise a relatively short question: “Does this set of facts fit into this statutory provision in this way or in that way?” Of course, it can always take quite a while to discover and to explain what the facts are, but the question of law which arises in each tax case is typically very narrow: what do these words mean? In essence, you are either within a statutory provision or outside it. And yet the judgements in all these Ramsay cases go on for pages. I have not counted them but there are several hundreds of them, perhaps now well over 1,000. What are they all saying?

In order to understand that, it is necessary to understand something of the role of the judge. Under a Westminster style constitution operating a common law system the judge is not a primary legislator. His primary function is to declare the law. Now, of course, as the House of Lords has interestingly explored in Kleinwort Benson Limited v. Lincoln City Council¹⁰ the notion that all that a judge does is to declare the existing law is too jejune to be acceptable these days. Lord Goff says this:

“In the course of deciding the case before him [the judge] may on occasion develop the common law in the perceived interests of justice, though as a general rule he does this “only interstitially”, to use the expression of O.W. Holmes J. in South Pacific Co. v. Jensen (1917) 244 U.S. 2095, 221. This means not only that he

¹⁰ [1999] 2 AC 349

must act within the confines of the doctrine of precedent, but that the change so made must be seen as a development, usually a very modest development, of existing principle and so can take its place as a congruent part of the common law as a whole. In this process, what Maitland has called the “seamless web”, and I myself (*The Search for Principle*, Proc. Brit. Acad. vol. LXIX (1983) 170, 186) have called the “mosaic”, of the common law, is kept in a constant state of adaptation and repair, the doctrine of precedent, the “cement of legal principle”, providing the necessary stability. A similar process must take place in codified systems as in the common law, where a greater stability is provided by the code itself; though as the years pass by, and decided cases assume a greater importance, codified systems tend to become more like common law systems.

Occasionally, a judicial development of the law will be of a more radical nature, constituting a departure, even a major departure, from what has previously been considered to be established principle, and leading to a realignment of subsidiary principles within that branch of the law. Perhaps the most remarkable example of such a development is to be found in the decisions of this House in the middle of this century which led to the creation of our modern system of administrative law. It is into this category that the present case falls; but it must nevertheless be seen as a development of the law, and treated as such.”

But, even though we now recognise that judges develop law, they must, as the passage I have just read emphasises, still act within the confines of the doctrine of precedent. It follows that if we are to apply the *Ramsay* doctrine we need to understand the precedents. It is, of course, trite law that a case is only authority – is only a precedent – for what it actually decides and, up to this point in the story, none of the judges had really paused to make a detailed analysis of the precedent value of these *Ramsay* decisions, which could certainly be regarded as lacking coherence.

It is at this stage of the *Ramsay* doctrine’s history that we get the *MacNiven*¹¹ decision. Now that case has given rise to some controversy, but I think its chief achievement is that Lord Hoffmann pulled together all of the cases and provided a framework on the basis of which it is possible to take a rational view of what the cases

¹¹ [2003] 1 AC 311.

actually decided. There has, of course, been a great deal of comment on the distinction which Lord Hoffmann drew in *MacNiven* between legal and commercial concepts. In my view, however, far too much emphasis has been put on this distinction and far more than Lord Hoffmann intended: to concentrate on what he says about the legal and commercial distinction is to take it out of context and to ignore other passages in his speech. I have, of course, been making my own analysis of the precedent value of the *Ramsay* cases for many years and one reason why I like the approach adopted by Lord Hoffmann in *MacNiven* is that his analysis there is very similar to my own analysis. As I see it, what Lord Hoffmann is saying is that in every tax case the statute asks a question, and he makes the very important comment (at paragraph 58):

“The limitations of the *Ramsay* principle therefore arise out of the paramount necessity of giving effect to the statutory language. One cannot elide the first and fundamental step in the process of construction, namely to identify the concept to which the statute refers.”

Accordingly, in order to find the correct answer in a tax case, the statutory question must first be identified and then answered. But the starting point for any enquiry is the language of the statute because it is in that language that we find the statutory question.

PRINCIPLES

When a set of precedents is reviewed, a lawyer should be able to use the precedents so as to derive a set of principles. A lawyer does not say here is one case and it decided this and here is another case and it decided that. A lawyer must be able to extract principle from the cases. In my view the cases up to and including *MacNiven* establish five principles.

The First Principle

The true and only principle – the first and fundamental principle – is that the statute must be interpreted and applied to the facts.^A This involves

- (a) ascertaining what question the statute poses in the particular circumstances of the case^B; and
- (b) applying the appropriate analytical technique to find the answer to that question^C.

The process of finding the statutory question may be iterative in the sense that the statute and the facts may have to be examined more than once before the correct statutory question can be found. The analytical technique which is appropriate will vary according to the question asked. Some statutory provisions are fuzzy and ask wide ranging questions which invite a broad examination of the facts: others are very much more precise and require only an examination of whether a particular state of affairs exists at a particular time; there may be intermediate questions. A fuzzy question provides latitude for judicial exploration and exegesis. A precise question does not give or permit that latitude.^D

I set this out as the true and only principle. It provides a framework – an approach – to the correct solution of problems arising in relation to tax statutes. However, this principle is quite broad and it certainly leaves scope for error. For example, a judge can misidentify the statutory question, or he can apply the wrong analytical technique in answering the statutory question. I shall suggest, in a moment, that the wrong statutory question was asked in *Furniss v. Dawson* (although, if the question asked there were the right question, it was then correctly answered), and that the right questions were asked in both *Arrowtown* and *Carreras*, but the wrong (or no) analytical technique used in answering them. But despite this defect, the first principle is a good one, indeed an excellent one, because it ties the solution of any tax case tightly and indissolubly to the words of the statute, which ought to be a reasonably certain guide.

The Second Principle

The second principle is that when *Ramsay* was decided, there was no authority contrary to the true principle which I have set out as the first principle.^E The *Duke of Westminster* is not an authority

which is contrary to the true principle. It is only an authority which prohibits recharacterisation, and it does no more than that. All it decided, as I have said, was that an annuity could not be regarded as wages if it was in law an annuity.^F The result is that the true principle was the true principle both before and after Ramsay.^G Thus Lord Nicholls in MacNiven [2003] 1 AC 311 at 318 says:

“an initial point to note is that the very phrase “the Ramsay principle” is potentially misleading. In the Ramsay case the House did not enunciate any new legal principle.”

There is thus no contrast between Duke of Westminster and Helvering v. Gregory. The statute in each case asked a different type of question. In the Duke’s case the question was “Is this an annuity?” In Helvering v. Gregory the question was “Is this a plan of re-organisation?” The questions invite different techniques to be applied in answering them, because the one asked a precise question of law or characterisation while the other asks a fuzzy question of fact.

The Third Principle

There is no judicial overlay which extends, limits or varies the ambit of the statute, ascertained by applying the true principle. The statute does not have a penumbra which automatically strikes down tax avoidance.^H I have, of course, taken the reference to the statute not having a penumbra from Lord Hoffmann’s quotation in MacNiven of what he said in Norglen Limited v. Reeds Reins Prudential Limited [1999] 2 AC 1 at 14:

“It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes”.

This is to be contrasted with the approach of Judge Hand in CIR v. Ickelheimer¹²:

¹² 132 F.2d 660 (“d Cir 1943)

“But the colloquial words of a statute have not the fixed and artificial content of scientific symbols; they have a penumbra, a dim fringe, a connotation, for they express an attitude of will, into which it is our duty to penetrate and which we must enforce ungrudgingly when we can ascertain it, regardless of imprecision in its expression.”

There may, accordingly, be a divergence on this point between the approach of UK and US Courts, although it is fair to note that Judge Hand was dissenting in *Ickelheimer*.

The Fourth Principle

On a correct analysis all the so-called *Ramsay* cases are examples of the application of the true principle, and not examples of something different. At most, these cases contain a recognition that answering the questions posed by modern statutes in relation to elaborate transactions often (but not always) requires a full analysis of the facts, rather than an analysis of whether a state of affairs exists or whether, say, a particular payment has a particular quality.¹ This is not because the principle has changed but because of the question raised by the statute on a true interpretation. None of the *Ramsay* cases involves a recharacterisation of what happened. In *Ramsay* the question was whether the taxpayer realised such a loss as the legislation was dealing with.^J The correct analytical technique was to analyse the facts to see whether there was a gain or a loss for the taxpayer.^K The fundamental question was a transactional or commercial question: was there a loss? It was not a qualitative one: it was not “what quality does this thing have?” In *Burmah Oil* the question was whether money apparently paid as consideration for an issue of shares was really so paid.^L The correct analytical technique was to analyse the facts to see whether the money was really paid for the shares or to pay for the repayment of group loans. It was actually paid to fund the repayment of group loans, so it was not, and could not be, the base cost for the shares. Again, it can be seen that the question at issue was transactional or commercial and that the answer was based on a construction of the TCGA provisions about base cost.^M

In *Furniss v Dawson* another transactional question arose. It was said to be whether the disposal was to the intermediate company Greenjacket or to the ultimate purchaser Wood Bastow.^N If the disposal was to Greenjacket a relieving provision could apply; if it was to Wood Bastow, the relieving provision could not apply. The correct analytical technique was to see to whom the disposal was made by considering the facts as a composite whole.^O The technique described is suitable to discovering whether a number of connected transactions constitute a single disposal or two disposals, which was said to be the issue in the case given the terms of the charging provision. An issue which arises in relation to *Furniss v Dawson* is whether the Court asked itself the correct statutory question. It is at least arguable that the question asked should have related to the issue of shares by Greenjacket, not to the disposal by the taxpayer. *Furniss v Dawson* may, accordingly, be a case in which the wrong question has been asked.

In *Craven v White* the question was (*mutatis mutandis*) the same as in *Furniss v Dawson*,^P and the correct analytical technique was the same as in *Furniss v Dawson*. However, the answer was different because the facts were different. In *Ensign Tankers*¹³ the question was the commercial one of how much expenditure had been incurred by the film making partnership,^Q and the correct analytical technique was to analyse the facts to see who really incurred the expenditure.^R In *McGuckian*¹⁴ the question was whether a company called Shurltrust got a dividend.^S The question was one of fact (who got this dividend?), and the correct analytical technique allowed the cash flows to be followed so that it could be seen who in reality received the dividend.^T In *MacNiven* the question was whether there was a payment of interest^U and the correct analytical technique was to determine whether, as a matter of law, the interest had been paid.^V Here the question was a legal one. In *Shiu Wing Steel* the question was whether a transaction which apparently involved a gift of foreign property^W could be analysed as a gift of Hong Kong property and the correct analysis involved an

¹³ [1992] 1 AC 655.

¹⁴ [1997] 1 WLR 991.

examination of the facts which showed that, however they were viewed, the gift must have been of foreign property.

The Fifth Principle

The analysis of the so-called Ramsay cases in relation to the fourth principle shows that the questions which arose in those cases – or, at least, which were said to arise in those cases – both invited and permitted a wide-ranging factual exploration. All those cases asked questions about transactions – and, so far as I can tell, the same is true of all the cases in this field in America. It is certainly true of Helvering v. Gregory. They are, accordingly, very different from the Arrowsmith and Carreras cases because, as I hope to show, those cases raised narrow legal questions of a very different nature from those which arose in the earlier Ramsay cases. Thus the cases before Arrowsmith and Carreras are not determinative of the outcome of those two cases.^X There is no binding precedent to be found in the earlier cases that is relevant to the questions which arise in Arrowsmith and Carreras. Indeed, what the five principles show when taken together is that, before Arrowsmith and Carreras, the Ramsay principle had had a brief flowering and then been reduced in potency to a part of the ordinary doctrine of statutory construction. There was really no such thing as a Ramsay doctrine.

These five principles provided a sensible and workable structure on which a coherent jurisprudence could be built; and more comfort could be drawn from three features of Lord Hoffmann's speech in MacNiven. First, there is his remark that the Courts do not have any constitutional authority to impose an overlay upon the tax legislation. This is a recognition of the limited role of the judge in relation to tax cases. Secondly, there is his comment that it is not sensible to approach tax cases by asking whether they involve avoidance or mitigation, since this can only be a conclusion reached after deciding a case rather than an aid to its decision. And, thirdly, there is his statement – to which I have already referred – that one must begin any tax case by interpreting the statute, construing the concepts in it. Every member of the House of Lords in MacNiven agreed with these principles. These are very healthy principles,

because they betoken a legal and rational approach to a problem as distinct from an emotional or political or moral one.

Arrowtown

Against this background it is possible to consider how the Arrowtown case looked before it was decided. Stripped of inessentials, Arrowtown was a 100% subsidiary of Shiu Wing Steel. For the purposes of this article it may be assumed that Shiu Wing Steel held all the shares in Arrowtown directly, and that the shares in Arrowtown are divided into two classes – 10 “A” shares of considerable value and 90 “B” shares of very little value. The “A” shares and the “B” shares are, however, of the same par value. Shiu Wing Steel has transferred land to Arrowtown and has then transferred the 10 “A” shares to a purchaser for a considerable sum of money. It retains the 90 “B” shares. The question is whether Arrowtown stays in the Shiu Wing group for the purposes of stamp duty: if it does, no stamp duty is payable on the transfer of the land to Arrowtown but, if it does not, stamp duty is payable on that transfer. The test of a group in Hong Kong is met if one company holds 90% of the issued share capital of the other company. On the face of it, this test seems to be met: Shiu Wing Steel holds before and after the sale of the “A” shares, all of the “B” shares and the “B” shares represent 90%, by par value, of the issued share capital of Arrowtown. The only way in which the Revenue can defeat the existence of the group is to say that the holding of the “B” shares is to be disregarded. But on what basis is this to be done?

As things stood before Arrowtown itself was decided, there were two ways of looking at the matter. The first way is to regard MacNiven as some kind of aberration and deal with the issue on what I might call classic Furniss v. Dawson lines. It will, of course, be appreciated from the praise that I have been heaping upon MacNiven that I do not myself see the case as, in any way, aberrant. But we know, those of us who are about to argue Arrowtown, that we are to appear before Lord Millett and we also know that Lord Millett does not himself like MacNiven. He certainly regards MacNiven as aberrant, as misconceived; perhaps he feels about it in the same way as a child seeing another playing with his toys without

permission feels. It is, accordingly, necessary to think about the matter as if *MacNiven* had not been decided. On this basis, we turn to Lord Brightman's classic formulation of the principle in *Furniss v. Dawson* in which he says that if there is a pre-ordained series of transactions into which steps have been inserted with no commercial purpose, the inserted steps are disregarded for fiscal purposes so that:

“the Court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied”.

In *Arrowtown*, then, if the case is approached on classic *Furniss v. Dawson* lines, one feels very comfortable. The end result is to be taxed. The end result is that there are shares in existence and the group is still in being. *Furniss v. Dawson* does not give any encouragement to the Revenue.

The second way of looking at *Arrowtown* is to say – as I believe is true – that *MacNiven* provides a true synthesis of all the cases so that the only issue which arises in this case is whether the “B” shares held by Shiu Wing Steel are “issued share capital”. However one looks at this question it seems that the answer must be yes – and if one focuses on Lord Hoffmann's distinction between legal and commercial concepts, the concept here must surely be a legal one, so that there is no scope for ignoring the existence of the “B” shares.

A third possible way of looking at the matter is to say that there is a no business purpose test which applies in relation to tax statutes. Lord Millett wrote about this in his article in the BTR in 1986. However, while it is easy enough to see how a no business test can be read into transactional or commercial questions like: “is this a reorganisation?” it is difficult to see how it can be applied to a static question like: is this issued share capital? Hard to see, then, why the no business purpose test should be worrying. The position, accordingly, seems very sunny for the taxpayer, and, indeed, the Revenue's own argument did not seem very worrying. It was simply

that the Ramsay cases provided a general anti-avoidance rule which had to be applied to strike down tax avoidance devices.

Now, as I hope I have shown, the Ramsay cases are not authority for that sort of rule at all, and so the Revenue's case seemed almost laughable: indeed, it was treated in that way by all of the judges who heard the case until it got to the Court of Final Appeal. I might add that the Revenue's case was based entirely upon United Kingdom authorities and did not refer at all to cases from the United States. However, two days before the case began, Counsel were sent a note, by the Clerk to the Court of Final Appeal. The Court, said the note, wished to be addressed on the case of Helvering v. Gregory. Now, here is the insidious little worm in the apple of statutory construction awakening like the Kraken in the hope of destroying the apple. However, Helvering v. Gregory is not about the same sort of question as the question in Arrowtown. It is about whether there was a plan of re-organisation. The question in that case is active and does, at least, have some sort of commercial flavour. The question in Arrowtown is passive and static and qualitative: are these shares issued share capital?

Whatever melody this statute is playing it does not, to my mind, include any notes relating to the question of why these shares were issued. In the course of the argument Lord Millett suggested that the phrase "issued share capital" meant share capital issued for commercial purposes and he suggested, which was true, that the "B" shares had not been issued for any commercial purpose other than to create a group between Arrowtown and Shiu Wing Steel. However, the statutory wording is really quite detailed and accompanied by detailed rules for working out who is in a group and who is not in a group. And these rules are consistent only with treating issued share capital as part of an arithmetical calculation, by reference to par values, in order to determine whether a group existed or not. Parliament could have legislated in any way it chose to describe the circumstances in which a group did and did not exist. It chose to do so by reference to par values and all of this seems to me to be quite inconsistent with any form of business purpose test being inserted into the question of whether there is indeed share capital or not.

While I was arguing the case I must say I had the impression that four of the judges were with me and that I had persuaded Lord Millett that the question in Helvering v. Gregory was different from the question before him in Arrowtown. I was therefore both surprised and disappointed by the 5-0 decision against the taxpayer published in November last year. Lord Millett's judgement on the Ramsay part of the case starts with a paean of praise for Judge Hand's judgement in Helvering v. Gregory. This is a bad beginning: Helvering v. Gregory is not a good decision. Lord Millett then goes through the UK cases and demonstrates that they are all concerned with questions of construction. However, he does not adopt exactly the same analysis as Lord Hoffmann does in MacNiven and, where there are differences, I think that Lord Hoffmann's analysis of the case law is to be preferred.

There is also the rather extraordinary proposition that the true ratio of MacNiven is to be found in the speeches of Lord Nicholls and Lord Hutton, who suggest that there was nothing at all artificial in what happened in MacNiven, because the original loan, on which interest was later paid by a circular transaction, was made in the real world and without there being any artificiality. This conclusion seems to me to ignore the fact that every member of the House of Lords concurred in Lord Hoffmann's speech. It is also unhelpful since the distinction between reality on the one hand and artificiality on the other is as hard to draw as the distinction between avoidance and mitigation. In truth these terms are conclusions, not aids to a reasoned conclusion. Lord Millett then goes on to disagree with Lord Hoffmann's approach in MacNiven and, particularly, the distinction that Lord Hoffmann made between legal and commercial concepts. However, as I have suggested, and as Mr Justice Ribeiro has said in his judgement in Arrowtown, the importance of this distinction must not be got out of proportion and I think this passage of Lord Millett's judgement seeks to create a war without a true cause. Moreover, while it is fair to say that the judgement up to this stage is critical of MacNiven, it is, in truth, not really very different from MacNiven. All it has said, up to this point, is that Ramsay cases are all about the construction of taxing acts. It is true that Lord Millett promotes the notion of a business purpose test in relation to taxing acts, but this is only an example of the purposive construction

of statutes espoused these days by more or less every judge; and Lord Millett is careful to point out, at paragraph 143 of his judgement, that the business purpose test is not a free-standing principle which yields an automatic solution in every case.

If the judgement had stopped there, it would simply have been a case of one judge disagreeing a little bit with another judge, but not, in truth, very much. Up to this point – paragraph 151 of his judgement – this is a jolly good read and not at all distressing. But something funny happens in the last five paragraphs. Suddenly the case falls squarely within the Ramsay approach. Now that is odd because, as I hope I have shown, the Ramsay cases as precedents do not decide this case, and the approach in them is limited to transactional questions, not qualitative ones like the one in Arrowtown. Lord Millett may recognise this difficulty because, in this part of his judgement, he treats the issue of the “B” shares as part of a larger transaction which suggests, in a way, that he is treating the question here as the sort of question which arises in Furniss v. Dawson. A question like “Is there an inserted step?” But he then does not follow this line of reasoning through, and indeed, he could not follow that reasoning through, because the question in Arrowtown is not a transactional question. At paragraph 154 of his judgement he says that the question of whether the “B” shares can be left out of account when applying the statute depends on the purpose for which the section was enacted, and he utters the, to me, mystical two sentences that if the 90% “test is not satisfied there can be no relief. But it does not follow that if the test is satisfied there must be relief”. How can you pass the test and still fail it? The world of quantum physics returns to us. In the end the whole of Lord Millett’s reasoning for the decision is in paragraphs 156 and 157 of his judgement:

“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.

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 have 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 should be disregarded when calculating the proportions of the nominal share capital owned by Shiu Wing and Calm Seas respectively."

All I can say about those passages of the judgement is that there is nothing in the statute which enables one to determine that the purpose with which the shares were issued is relevant to the question of whether they are issued share capital. Indeed, a test which requires you to ask why shares were issued inevitably recognises the fact of issue; and it is odd that a test which recognises the fact of issue should then lead to the conclusion that shares were not issued.

What has happened here is that Lord Millett has assumed that Parliament intended there to be some form of economic test as well as a nominal value test before there can be a group. But it is quite apparent, not only from a reading of the legislation but also from authority – *Canada Safeway v. Thomson* – and from the subsequent introduction of an economic test, that Parliament did not intend an economic test in the original form of the legislation. What Parliament did was to enact a generous grouping test, recognising that there may be cases in which the test went wrong but accepting, nonetheless, that the legislative test was good enough to cover most cases. Parliament did not leave some sort of lacuna to be filled in by a judge: it did not, for example, say "there will be a group if you have 90% of the share capital and a judge thinks it's the right sort of share capital." It said there will be a group if one company holds 90% of the issued share capital of another. It did not tell us to ignore preference shares or to take account only of equity share capital or ordinary share capital. And even on Lord Millett's test a company which had 10 ordinary shares and issued 90 preference shares for a

commercial reason would be in a group with the holder of the preference shares, even though it only had, say, 2% of the equity. It is thus just not possible to find a sensible economic or commercial test underlying the legislative requirements for a group and, if that is so, how can the purpose with which shares are issued tell us anything about whether they are issued share capital or enable a group to be formed? I may say that all sorts of issues which were considered in argument arise out of this sort of decision. When are shares issued for a commercial purpose? Would it have made a difference if the shares carried bigger dividends and, if so, how much bigger? What would have happened if the originally issued share capital of the company had been converted into different classes so that there was no issue of shares for the purpose of creating a group?; and so on.

There is nothing objectionable in the reasoning that precedes the conclusion of this case. As I say, all it says is that you must construe the statute. However, the conclusion itself is undesirable for at least four reasons. First, it really does not represent a conclusion that can be reached on a fair reading of the statute, unless there is some judicial overlay upon the statute. And, as Lord Hoffmann observes in *MacNiven*, the judges have no constitutional authority to create an overlay upon a tax statute. Secondly, it applies to a static passive qualitative question an analytical technique which is only suitable to an active transactional sort of question. The question “Is this issued share capital?” does not respond in any way to an analysis of why the share capital was issued. Share capital is either issued or it is not. Thirdly, it illustrates the dangers of the so-called purposive construction of legislation. In the end, the purpose of legislation can only be properly determined by looking at the words of the statute, and if judges go outside the words of the statute to find the purpose of the words they are, in truth, not construing legislation but finding an excuse to reach the conclusion they want to reach. Inevitably, that will be a conclusion which is not justified by the words of the legislation. We all know that, when a judge says “this must be construed purposively” he is going to interpret the relevant instrument to mean something it does not say. In *Arrowtown* Lord Millett has found that a purpose of the legislation is not to permit abuse of a relief by permitting outsiders to have a

significant equity stake in a group company. He accordingly interprets the words “issued share capital” to mean “share capital issued for a commercial purpose”. But this interpretation does not fulfil the purpose he has found to exist for the legislation, since there will be many circumstances in which shares are issued for commercial purposes and there is a group even though an outsider has a large equity stake in the company. This suggests that Lord Millett’s interpretation must be wrong, since it does not fulfil the supposed purpose of the legislation. If Lord Millett’s interpretation is wrong, one is then forced back on the literal words of the statute, and there is nothing suggestive of purpose in them. Fourthly, by this decision Lord Millett has created parallel universes. In the company law world, the “B” shares exist as issued share capital. In the tax world they don’t exist. Quantum physics again. Some quantum physicists believe in the possibility of parallel universes: Fred Hoyle wrote about it in a novel called *October 1st Is Too Late*. But what use is this concept to those of us who have to live in the every day humdrum world?

Arrowtown was obviously, for me, a disappointing decision; and it seemed to me to be wrong. But Carreras loomed on the horizon and with it the hope of wresting something back from the wreck of my hopes in Hong Kong.

Carreras

However, if Arrowtown had seemed a certain winner on the Ramsay point Carreras was, in many ways, more doubtful. Jamaica has a transfer tax which is partly a form of stamp duty and partly a form of capital gains tax. It is charged on transfers of Jamaican property at a flat rate of 7½% of the consideration for the transfer. However, where shares are concerned there is a relief. If shares in a Jamaican company are transferred to another company in exchange for an issue of shares or debentures, there is no charge to tax on the transfer. The provision which says this is an exact copy of the original form of TCGA 1992 s.135. The Jamaican Act goes on to provide that, if shares in a company are redeemed or re-purchased by the company, there is deemed to be a transfer of the shares and transfer tax is payable accordingly. But there is nothing in the Act

about the redemption of debentures. So Carreras sold shares in the Jamaica Biscuit Company to a company called Caribbean Brands Limited in exchange for the issue of a debenture. The debenture was in the sum of US\$37m and was to be redeemed, without interest, about two weeks after it was issued. The question posed by the statute was whether there was an issue of a debenture in exchange for shares.

How did I feel about that, just after Arrowtown and before arguing Carreras? I was not very bothered by the actual result in Arrowtown. On a broad view, Arrowtown could be seen as a decision that relieving provisions in the legislation only operate where there is a business purpose involved in the relevant transaction. But this cannot be right in relation to a provision like s.135 which does not have attached to it the bona fide commercial requirements of s.137. We know that there is – or should be – no business requirement in s.135 read on its own or in the equivalent provision of the Jamaican legislation, which certainly does not have s.137 attached to it. This is inherent in the decision in Craven v. White: if business purpose was an inherent part of the s.135 test, the taxpayers could not have won in Craven v. White; so I am not actually very worried about Arrowtown as such; and, in any event, there are going to be different judges sitting in Carreras from those who sat in Arrowtown and some of those judges can be expected to be unsympathetic to the Arrowtown approach. Moreover, if business purpose is part of the relevant test, there was a business purpose for the issue of the debenture in Carreras: it actually was the consideration for the transfer, which was all done for commercial purposes. Arrowtown is not really a worry.

But this debenture comes and goes in a way which might be seen as ghostly and its redemption might be seen as pre-ordained, so I am a little worried about what I might call the basic Furniss v. Dawson test. However, Furniss v. Dawson does not resolve this case. The question which was said to arise in Furniss v. Dawson was this: if A transfers property to B who immediately transfers the property on to C, does A dispose of the property to B or does he dispose of the property to C? That is not the question in Carreras, because Carreras transfers the property to B and it stays in B.

The question is not what Carreras did with its property but what it got for its property. Did it get a debenture? This question is not answered by Furniss v. Dawson or, indeed, any of the previous cases, with the possible exception of the Duke of Westminster. So really it ought to be possible to walk unscathed through the minefield of the past authorities and show that there was nothing which required or permitted the debenture to be ignored. There is, of course, a concern that the Court might take a Judge Hand-like approach and just say “Well, this debenture is just not the sort of debenture the legislation is talking about”. But it seems very difficult to take that line looking at this legislation. When children are learning ballet dancing they are told about good toes and bad toes – or, at any rate, mine were – but this legislation does not suggest that there are good debentures and bad debentures. There are only debentures. And there aren't good or bad issues of debentures or good and bad exchanges: there are just issues of debentures and exchanges. So, although there is a Hand-like concern in the background, that should not really give rise to a decision against Carreras on a fair reading of the legislation. But there is still this concern that the debenture comes and goes in such a short space of time: it can be said that the payment of cash is pre-ordained and all of that sounds just a little like Furniss v. Dawson. However, it only sounds like Furniss v. Dawson: it isn't Furniss v. Dawson because, as I have said, the question in the case is different. Moreover, the concept of pre-ordination in Furniss v. Dawson was used solely for the purpose of treating a non-contractual arrangement as if it were a binding contract; and this cannot be a useful analysis in the case of a debenture which is always contractually due to be redeemed at some point. If a debenture is not to be a debenture just because it is to be redeemed, no debenture can ever be a debenture.

However, one can see that a judge who wishes to decide in favour of the Revenue can seize upon these things to reach the conclusion that the debenture can be ignored. How was I to deal with that concern? The answer is to look at the structure of the tax. In relation to a transfer of shares in exchange for an issue of a debenture, the legislation concentrates on the moment of issue. Is what is issued in exchange for the shares a debenture? How can legislation which asks that question look beyond the point of issue

in seeking the answer to the question “Is this a debenture?” The answer is that it cannot; and we know that it cannot, because the legislation deals separately, in the case of shares issued in exchange for shares, with the redemption of the shares and, indeed, in this country, the redemption of the debenture is also dealt with separately. It is thus very clear that the structure of the tax is to look at the point of issue in order to determine whether the relief is available and then to look at the point of redemption to see whether there is another charge to tax then. Issue and redemption are dealt with separately. However, for whatever reason, the draftsman in Jamaica did not deal with redemptions of debentures. I do not know why he did not deal with it: I only know that he did not.

So the real complaint of the Revenue in *Carreras* is that the legislation does not deal with the redemption of debentures and they are asking the Courts to supply that omission. It is a clear case, in truth, of asking the Court to legislate which it does not have power to do. This seemed to me to be a very strong point indeed but, in the course of argument in the Privy Council, it rapidly became quite clear that Their Lordships were not impressed by it. It was accepted that a debenture was issued. It was accepted in argument, though this is not reflected in the judgement, that if the issue of debentures had to be registered at Companies House, then the issue of this debenture had to be registered. And it was accepted that if s.765 consent or something similar was needed for the issue of debentures then that consent would be needed for the issue of this debenture. But it became apparent in argument that, even though all that was so, relief was not going to be given in this case and, in the result, it was not given.

In some cases there is scope for doubt about the question which the statute is posing and there is room, as I have said, for considerable judicial flexibility in deciding what question the legislation is, indeed, asking. For example, in *Furniss v. Dawson* the House of Lords said that the question was, “To whom did the Dawson family dispose of the shares in the operating companies?” and, as I have said, it is actually quite difficult, looking at the legislation, to see why that is the question, although there are at least arguments that it is the question. But in *Carreras* there is no

disagreement about what the question is and there is no playing fast and loose with it: it is whether there was an issue of a debenture in exchange for shares. The Privy Council has held that there was not and I am not sure that I can tell you how they have held that.

Having posed the question as to whether there was an issue of a debenture the Privy Council then goes on to ask whether the “relevant transaction” is just the issue of the debenture or the issue of the debenture coupled with its redemption. There is an elision here. The Privy Council says that the question is whether there was an issue of a debenture but it then goes on to answer a different question. The different question which it goes on to answer is whether there was a relevant transaction which included the redemption of the debenture. Is it, perhaps, possible that Lord Hoffmann has here elided the first and fundamental step in the process of statutory construction – the need to give effect to the statutory language? I ask that question because the statute in *Carreras* does not ask whether the “relevant transaction” included the redemption of the debenture. It asks whether there was an issue of a debenture.

Lord Hoffmann seeks to justify the jump from a question about the issue of a debenture to a question about a relevant transaction in paragraph 8 of his judgement:

“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. 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.”

It is to be noticed here how the Ramsay principle is downplayed to a point of such insignificance that no citation of authority is now needed. And this insouciance about Ramsay is so breathtaking that it distracts attention from two points. The first point is that the Ramsay approach is said in this passage to apply in particular to revenue statutes – a move away from the recent trend of saying that there is one rule applicable to the interpretation of all statutes. The second point is that this passage does not actually justify the leap from issue to relevant transaction because it does not explain why the language of this statute is concerned with anything other than the question of issue. Which language of the statute is being construed here? And even if there were something in the language of the statute that extends the scope of the enquiry beyond issue, this approach is said to apply only where there is commercial unity in a transaction and I very much doubt if the issue and redemption of the debenture in this case really do have a commercial unity. Test it this way: how many readers will lend me US\$37m for two weeks unsecured on the basis that lending the money to me is the same as having the cash in their pocket? However, it is plain from paragraphs 15 and 16 of Lord Hoffmann’s judgement that Carreras was treated as if it had actually had US\$37m in its pocket when it got the debenture.

“Mr Goldberg submitted that a factual inquiry into what constituted the relevant transaction for the purposes of paragraph 6(1) 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?

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 as short a 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.”

It seems to me that this is a wholly unreal characterisation of what happened, especially on the facts of the case when the debenture did not actually redeem on time or in the currencies payable under it.

What about the argument that the structure of this tax points us to the time of issue rather than the time of redemption when we are considering the relieving provision? Apparently, as appears from paragraph 13 of Lord Hoffmann’s judgement, to read the legislation in that way does not produce a rational system of taxation.

“Their Lordships do not accept that meanings can be transposed in this way from the legislation of one country to that of another. The United Kingdom statute requires the exchange and the redemption to be considered separately, under paragraphs 6(1) with 4(2) and paragraph 11 respectively, because that is in accordance with the scheme of the tax. Such treatment creates a rational system of taxation. The Jamaican legislation, although it uses much of the same language, is concerned with a different kind of tax. A restricted interpretation of the transaction contemplated by paragraph 6(1) would produce the result that exemption from tax could be obtained by a formal step inserted in the transaction for no purpose other than the avoidance of tax. This would not be a rational system of taxation and their Lordships do not accept that it was intended by the legislature. They agree with the majority of the Court of Appeal that the relevant transaction for the purposes of this legislation comprised both the issue and the redemption of the debenture and that such transaction, taken as a whole, could not be appropriately characterised as an exchange of shares for a debenture.”

However, although Their Lordships do not say so, it is manifest that, where there is a share for share exchange, the legislation in giving relief is concentrating on the point of issue. There really cannot be any doubt about that. So how can the position be different where there is an issue of debentures? Is it rational that, if I do a share for share exchange, the provision looks at the point of issue, but if I do a share for debenture exchange it combines the issue and redemption? The answer is surely “No”, and I do not believe that the legislature

intended anything beyond the point of issue to be relevant to the question of whether relief was available. Indeed, it appears that the Court takes as rational only a system of tax which imposes tax. This can only be right if tax is part of the law of nature; and it isn't. All tax systems are artificial constructs with arbitrary boundaries between what is taxable and what not, most of which are not defensible on rational or logical grounds. The only clear way of thinking about tax is to assume there is no liability to it unless it is clearly imposed by the statute. In the early days of income tax this was well recognised and the passage of time has not made it wrong. The rightness of the early view is demonstrated by the Privy Council's view that it is not every debenture which can be ignored: if a debenture has a long enough life regard will be paid to it. It follows that, at least to some extent, a tax system can not impose tax and still be rational. However, we are not told how long a life a debenture must have before it is regarded as a debenture, before it becomes rational for the tax system to grant a relief. Their Lordships do not have any answers for us on this. Here we are plunged into an area of uncertainty. The reason is that there is no rational or logical stopping place short of recognising all debentures or refusing to recognise all debentures. The appeal to reason is, in truth, only a claim that sentiment supports the conclusion reached.

THE LESSONS

So what lesson do I learn from Arrowtown and Carreras? Quite obviously the debenture had too short a life and there is a temptation to go away from Arrowtown and from Carreras and say "Well, it would have all been different if the instruments had been a little bit better. If, in future, I give my shares more rights, make the debenture last 3 months, it will all be alright." That is tempting but I think it's unreal. MacNiven, quite wrongly, was seen as a taxpayer's charter. That was wrong because, in focussing in the way the House of Lords did there on statutory construction, the judges fashioned a very flexible and powerful weapon which, even if tightly attached to the words of the statute, still left scope for error. But, even so, the judges are plainly not satisfied with that rule. I think they believe that MacNiven might indeed have been perceived as a taxpayer's charter and wish to send the message that it is not. Nonetheless, I do

not see Arrowtown as really very different from MacNiven in its reasoning. It is only in its conclusion that Arrowtown seems extreme. And one thing that can at least be said about Arrowtown is that there is in it an attempt to link the conclusion to the words of the statute. We can at least say: here is the reason given; and there is a basis for the decision with which we can agree or which we can criticise.

It is more difficult to do that with Carreras, because it is hard to see the basis for the decision: Lord Hoffmann has definitely moved in Carreras from the stance that he took in MacNiven. In Carreras, contrary to everything that he said in MacNiven, he has approached the interpretation of the statute by beginning with the question of whether there was avoidance or not. This appears from paragraph 13 of his judgement and readers will recall that it is contrary to the view he expressed in MacNiven, which was that avoidance was a conclusion to be reached only after the case was decided, not an aid to deciding it. It is also to be noted that, in paragraphs 15 and 16 of his judgement, Lord Hoffmann moves to a factual analysis containing references to pre-ordination and inserted steps which are more reminiscent of the traditional Furniss v. Dawson approach than the flexible and more accurate MacNiven approach. I think this is to be regretted.

Which decision do I think is worse? In my view Carreras is worse than Arrowtown. At least in Arrowtown Lord Millett has, as I say, gone through a process of reasoning and I know that he reaches his result by a supposed interpretation of the statute. I find it difficult to see how Lord Millett can have interpreted the statute in the way he did but I do, at least, know that that is what he says he is doing. What is Lord Hoffmann doing in Carreras? Is he interpreting the statute? Is he applying a factual rule based on pre-ordination? Is he purporting to do both at once? Is he applying a business purpose rule? Or is he creating a substance over form rule? (He refers to formal documents as not avoiding tax.) I think, if I may say so, that he is performing a conjuring trick. He says he is interpreting the statute but he then applies factual tests to answer a question which is not posed by the statute. All I know is that, at the end of his judgement, the debenture has, to some extent, disappeared and, if

this were a Sherlock Holmes story, it might be called “The Case of the Disappearing Debenture”.

However, the debenture has not altogether disappeared. It is to be borne in mind that, like the shares in *Arrowtown* which are there and not there at the same time, the debenture in *Carreras* is also there and not there at the same time; and so this brings me to the lessons to be learnt from Schrodinger’s cat¹⁵. In order to illustrate the uncertainty principle, Schrodinger posited the idea of a cat in a locked box. The cat has round its neck a radioactive phial which will be opened and will kill the cat if certain particles pass through it. The box in which the cat is locked is surrounded by these particles. The only way you can tell whether the cat is alive or dead is by looking in the box. But, just by looking in the box, you will make the particles pass through the phial so that, when you look, the cat will certainly be dead. The cat, says Schrodinger, is 100% dead and 100% alive at the same time. In *Arrowtown* and in *Carreras* the shares and the debenture exists for all purposes except tax and so are, like the cat, 100% alive and 100% dead all at the same time. But when you look at them, as you must to analyse their tax consequences, they are definitely dead and not there.

Can I draw any lessons from this? Well, I think one lesson is that if tax planning requires the Court to concentrate on the nature of a particular instrument, it is unlikely that that instrument will survive the intensive scrutiny which it is put under. So if tax planning depends on minute analysis of a chose in action *Arrowtown* and *Carreras* suggest to me that it is unlikely to succeed. Can any more general lessons be drawn from these cases? There is at least one possible synthesis of the two cases, and it comes from *MacNiven*. In *MacNiven*, Lord Hoffmann examines *Helvering v. Gregory* (albeit I am not sure that he accurately sets out the issues which arose in it) and sets out what it is authority for. It is, he says, authority for this proposition (see paragraph 36):

¹⁵ Lord Hoffmann is also interested in Schrodinger’s cat – see *Kleinwort Benson v. Lincoln CC*.

“An exemption from tax could not be construed as applicable to a transaction with no business purpose except to obtain the exemption from tax.”

The rule here is expressed in terms of exemptions and transactions, but perhaps it can be extended to reliefs and instruments. Perhaps the rule is that an instrument will not bring a person within a relieving provision if it is created with no business purpose except to obtain the relief from tax. I do not say that is the rule. There is nothing express in *Carreras* about a rule like that. It should not be the rule because such a rule could not be created by judges without putting an overlay on the statute, and they have no authority to do that. But the conclusions reached in *Carreras* and *Arrowtown* have the effect of creating a rule like that. Lord Millett would, although he has not said exactly that in *Arrowtown*, I think, be happy for something like that to be the rule. Do *Arrowtown* and *Carreras* tell us anything about what will happen when *Barclays* reaches the House of Lords? I think we can predict with some certainty that the *Barclays* decision will adjust the stance of Their Lordships in *MacNiven* but, depending on the composition of the House which hears the case, the adjustment may not be too great. Lord Walker in his recent Chancery Bar Association lecture has commended the distinction between legal and commercial concepts as a valuable insight, and I think it will not be altogether abandoned. Moreover, I hope that the House of Lords will continue its emphasis on the interpretation of statutes and, for my own part, I believe that the technique of finding the statutory question and answering it remains valid. Nonetheless, I think we shall see more emphasis on the factual aspects of the *Ramsay* rule and it is even possible that there may be some talk of recharacterisation. If the case is regarded as raising a point of law, a possible analysis is to say that relieving provisions give relief so long as the transaction has a commercial purpose other than tax avoidance. In a sense this would be the obverse of the synthesis I have suggested for the *Arrowtown* and *Carreras* cases and would indicate that the proposed synthesis – that you don't get relief if that is all you are after – is correct. On this basis, I would expect *Barclays* to win, since they obviously had a commercial purpose beyond tax avoidance. I should, however, perhaps add that there does seem to be a very easy way of dealing

with the Barclays case which sidesteps all these issues. I cannot, for my own part, understand how the question of whether expenditure was incurred on the provision of plant – the point at issue in Barclays – is a question of law. It seems to me as plain as day that it is a question of fact and it has been decided by the Commissioners. Nonetheless, my own guess is that Barclays will win on the basis that they did have a commercial non-tax avoidance purpose for their transactions.

AFTERTHOUGHTS

These cases of Arrowtown and Carreras are not as shocking to us as the original Ramsay decision. In part that is because we are better inured to shocks than we once were. But these decisions are disappointing and lacking in coherence, and that is of some concern. And they raise another concern. At least with the benefit of hindsight it is possible to say that Ramsay and Furniss v. Dawson and even Burmah Oil were decided within the proper limits of the judicial function. However, the question which arises is whether Arrowtown and Carreras were decided within the proper bounds of the judicial process. There is always uncertainty in litigation. There are always shocks for litigants and not just in the field of tax. It used, for example, to be thought lawful to kill and eat the cabin boy if you were shipwrecked at sea. Messrs Dudley and Stephens found out that it was not lawful, though they were spared the gallows; and so on. This is because the law is very flexible. As Mr Justice Cardozo said:

“Our survey of judicial methods teaches us, I think, the lesson that the whole subject matter of jurisprudence is more plastic, more malleable, the moulds less definitively cast, the bounds of right and wrong less preordained and constant, than most of us, without the aid of some such analysis, have been accustomed to believe. We like to picture to ourselves the field of the law as accurately mapped and plotted. We draw our little lines, and they are hardly down before we blur them. As in time and space, so here. Divisions are working hypotheses, adopted for convenience. We are tending more and more toward an appreciation of the truth that, after all, there are few rules; there are chiefly standards and degrees. It is a question of degree whether I have been negligent. It is a question of degree whether in the use of my own land, I have

created a nuisance which may be abated by my neighbour. It is a question of degree whether the law which takes my property and limits my conduct impairs my liberty unduly.”

But nonetheless all this flexibility is still restricted by the role of a judge bound by precedent and limited to the job of making small incremental changes to the law without being allowed fully himself to make it. I may be over-involved in these two cases, but I think that the judges in them have started with a moralistic stance and have interpreted the relevant statutes in a way which is not sustainable. This is a cause for concern. The question of whether tax should be paid or not is not, upon a true analysis, a moral question at all but only a political one and so fundamentally beyond the judicial role. Tax avoidance is not a problem but an opportunity from which everyone will benefit. Tax avoidance, unlike evasion, does not remove money from the known economy but leaves it working there to provide jobs and buy goods, to improve margins, to increase profits and in the end to produce a greater tax take than would have existed without it. To be against avoidance is to be economically naïf. Tax impinges on everybody's life, and it is not the role of the judge to decide how it should impinge, but only to follow what Parliament has said.

It is sometimes said that taxes are the price we pay for civilisation. That is wrong. Taxes are the price we pay for services. The price we pay for civilisation is that we allow things to happen of which we do not approve – and one of the things we must permit if a liberal democratic society is to survive is that people do not pay tax unless the law says so, unless Parliament has imposed the tax. I do not believe that in either *Arrowtown* or *Carreras* Parliament had imposed the taxes found to be due. I believe those cases have been misdecided. In my view both these cases have been decided so that tax is payable when it should not be. We should certainly find it shocking if a judge were to find a man guilty and send him to prison when the law seemed to us plainly to show that he was not guilty; and very few judges, at least in a free political system, would do that. How would we feel about *Arrowtown* if the price of the finding there was not a group was not money but imprisonment? How would we feel about *Carreras* if the penalty for not issuing a

debenture was not transfer tax but 7 years? Of course, tax is a matter of money and not individual liberty but it impinges on everyday lives at least as much as and perhaps more than the criminal law. There is some reason for upholding its sanctity by which I mean interpreting the words of the statute according to what they actually say and not according to what a judge supposes they should have said.

I think judges are eager to decide tax cases against the taxpayer because tax avoidance is wrongly unpopular at the moment. But there is danger when judges follow a populist movement, as Judge Richard Posner of the Federal Court of Appeals has correctly written:

“Perhaps in the fullness of time the growing of marijuana plants, the “manipulation” of financial markets, the bribery of foreign government officials, the facilitating of the suicide by the terminally ill, and the violation of arcane regulations governing the financing of political campaigns will come to be no more appropriate objects of criminal punishment than “dishonouring the race”. Perhaps not; but [the story of the German judges] can in any event help us to see that judges should not be eager enlists in popular movements of the day, or allow themselves to become so immersed in a professional culture that they are oblivious to the human consequences of their decisions.”

As we move from the nation state to the opportunity state, from physical wealth creation to electronic means of trading, I believe that the notion of tax avoidance as something to be stamped on by judges will become increasingly old fashioned and will eventually disappear. But we may have to wait some while for that. In the meantime I shall find solace in John Masefield’s poem *Tomorrow*, the final verse of which reads as follows:

And here, upon the turret top, the bale fires glower red
 The wake lights burn and drip about our hacked disfigured dead
 And many a broken heart is here and many a broken head
 But tomorrow
 By the living God we’ll try the game again.

^A *IRC v Duke of Westminster* [1936] AC 1

Lord Tomlin: p.16 (first paragraph)

“My Lords, it cannot I think be doubted that each one of the annuities payable under the deeds of covenant brought to your Lordships’ attention, if considered with reference to the deed creating it and without regard to the other matters upon which the appellants rely, **falls into that class of payments which are treated as part of the taxable income of the payee and not of the payer. Each annuity is on this footing therefore an item from which the payer is entitled to deduct income tax and which he is entitled to treat as deductible from his total income in making his return for surtax purposes.**”

Lord Russell of Killowen: p.22 (first paragraph)

“If the payment of these sums is payment of salary or wages within Sch. E (1), from which tax is not deductible by the Duke, then he is not entitled to exclude the amounts paid in ascertaining his total income for surtax purposes, but **if the payment is an annual payment within Sch. D, from which tax is deductible by the Duke, then he is entitled to exclude the amounts paid in ascertaining such total income.**

There can I think be no doubt that if the deeds stood alone the payments are annual payments within Sch. D. Indeed, this is not I think disputed. It is, however, argued that certain letters written by the Duke’s solicitor to the covenantees and certain acknowledgments signed by the covenantees at the foot of those letters, effect a complete change in the situation, and turn the payments made under the deeds into payments of salary and wages within Sch. E”

Lord Macmillan: p.26 (first full paragraph)

“It is agreed on all hands that the legal effect of this deed was to give Allman thereafter for the period of its endurance the right to a weekly payment of 38s. irrespective of whether he remained in the respondent’s employment or not, but without prejudice to Allman’s right to remuneration for such services as he might thereafter render to the respondent. **I do not think that there can be any doubt, and indeed none was suggested, that, if this**

deed had stood alone, the sums paid to Allman in pursuance of it would have been of the nature of an annual payment payable as a personal debt or obligation by virtue of a contract within the meaning of Rule 1 applicable to Case III. of Sch. D, with the result of entitling the respondent, under Rule 19, sub-s. 1, of the Rules applicable to all the Schedules, to deduct income tax on making the covenanted payments to Allman, and consequently to deduct the amount of these payments in computing his total income for surtax purposes.”

p.27 (last paragraph) and p.28 (to end of speech)

“My Lords, I venture to suggest that the proper approach to the problem is to ask the question, in the language of Rule 1 applicable to Case III. of Sch. D: Is the 38s. a week of the nature of an annual payment payable by the respondent as a personal debt or obligation by virtue of a contract? Plainly it is, and none the less so because of the collateral arrangement which, whatever it does, does not convert the deed of covenant into a contract of employment, for the 38s. remains payable, employment or no employment. It is agreed that if Allman leaves the respondent's employment the weekly payments which he will continue to receive under the deed will fall within Rule 1 applicable to Case III. of Sch. D. But the payments made to him while he remains in the respondent's employment are exigible by him under precisely the same legal obligation on the part of the respondent. If then the question which I have put must be answered in the affirmative, Rule 19, sub-s. 1, of the Rules applicable to all Schedules automatically applies and the respondent is entitled to deduct tax on making the covenanted payments to Allman, and if he is entitled to deduct tax from the payments he is also entitled to deduct the amount of these payments in computing his total income for surtax purposes. The same reasoning is applicable to the respondent's transactions with his other employees, except that in the case of Mr Blow there was only a deed of covenant and no collateral letters. His case is consequently a fortiori of the others.

I am fully conscious of the anomalous consequences which might conceivably arise in other connections from the course adopted by the respondent, but your Lordships are concerned only with the technical question whether the respondent has brought himself within the language of the income tax rule as to contractual payments, and I think that he has succeeded in doing so. That is enough for the decision of the case. It is not likely that many other employers will follow the respondent's example, for

few employers would care to take the risk to which the respondent has left himself exposed - namely, that his servants may quit his employment and take their services elsewhere and yet continue to exact the covenanted weekly payments from him.

The result of the views which I have expressed is that in my opinion the appeal should be dismissed and the judgment of the Court of Appeal affirmed."

W T Ramsay Ltd v IRC [1982] AC 300

Lord Wilberforce:

p.323, paragraph 1

"1. A subject is only to be taxed upon clear words, not upon "intendment" or upon the "equity" of an Act. Any taxing Act of Parliament is to be construed in accordance with this principle. What are "clear words" is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded: see *Inland Revenue Commissioners v. Wesleyan and General Assurance Society* (1946) 30 TC 11, 16 *per* Lord Greene MR and *Mangin v. Inland Revenue Commissioner* [1971] AC 739, 746, *per* Lord Donovan. The relevant Act in these cases is the Finance Act 1965, the purpose of which is to impose a tax on gains less allowable losses, arising from disposals."

p.326 (first full paragraph)

"I have a full respect for the principles which have been stated but I do not consider that they should exclude the approach for which the Crown contends. That does not introduce a new principle: **it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation.** While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still. Such immobility must result either in loss of tax, to the prejudice of other taxpayers, or to Parliamentary congestion or (most likely) to both. To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process. **In each**

case the facts must be established, and a legal analysis made: legislation cannot be required or even be desirable to enable the courts to arrive at a conclusion which corresponds with the parties' own intentions."

Craven v White [1989] AC 398

Lord Keith: p.479 (first complete paragraph)

"My Lords, in my opinion the nature of the principle to be derived from the three cases is this: the court must first construe the relevant enactment in order to ascertain its meaning; it must then analyse the series of transactions in question, regarded as a whole, so as to ascertain its true effect in law; and finally it must apply the enactment as construed to the true effect of the series of transactions and so decide whether or not the enactment was intended to cover it."

Lord Templeman: p.494 (first paragraph)

"It was also argued that *Furniss* involves double taxation. This argument is based on a misunderstanding. ***Furniss* only construed and applied the capital gains tax legislation.** By the scheme Dawsons "disposed" of the shares in the operating company for the price paid by Wood Bastow to Greenjacket. Dawsons made a capital gain of the difference between the price originally paid by Dawsons when they acquired the operating company shares and the price paid by Wood Bastow to Greenjacket at the behest of the Dawsons. The scheme also effected an "acquisition" by Dawsons of the shares of Greenjacket in consideration for the price paid by Wood Bastow to Greenjacket. If and when the Dawsons dispose of their shares in Greenjacket they will make a capital gain or loss of the difference between the price received by Greenjacket from Wood Bastow for the shares in the operating companies and the price obtained by the Dawsons on their disposal of the Greenjacket shares. There is no double taxation."

Lord Oliver: p.502 (end of first paragraph to end of page)

"It has been urged, in the course of the argument, that in *Furniss v. Dawson* this House crossed the Rubicon and that your Lordships should not be astute to confine the bridgehead thus created. That event, of course, constituted a declaration of war

upon the republic of Italy and I confess that I do not find the analogy drawn from so partisan an exercise an altogether happy one. I do not, however, quarrel with the general proposition, but before embarking even upon a reconnaissance into republican territory it is at least desirable to test what the bridge will support by an analysis of the means by which the crossing was effected. The first essential, therefore, appears to me to be to analyse the true basis and the legal justification for the decision in *Furniss v. Dawson* in order to see whether it does in fact rest upon or establish some wider principle of law which justifies the appellants' claim to recover tax from the respondents upon gains from which, no doubt, they benefited but which did not in fact directly accrue to them. **The second is to construe the relevant statute and to apply it to such facts as have been found or as may properly be inferred.**

My Lords, I confess to having been a less than enthusiastic convert to *Furniss v. Dawson* because I found, initially at any rate, some difficulty in following the intellectual process by which, in contradistinction to the cases which preceded it, it reconstructed the transaction which had taken place in that case in a way which disapplied the specific statutory consequences which, on the face of them, attached to the intermediate transfer which had in fact taken place and which the special commissioners had found as a fact was a genuine transaction. It has been said in the course of argument on the present appeals that *Furniss v. Dawson* is "judge-made law". **So it is, but judges are not legislators and if the result of a judicial decision is to contradict the express statutory consequences which have been declared by Parliament to attach to a particular transaction which has been found as a fact to have taken place, that can be justified only because, as a matter of construction of the statute, the court has ascertained that that which has taken place is not, within the meaning of the statute, the transaction to which those consequences attach.** It seems to me, therefore, that the first and critical point to be borne in mind in considering the true ratio of *Furniss v. Dawson* is that it rests not upon some fancied principle that anything done with a mind to minimising tax is to be struck down but upon the premise that the intermediate transfer, whose statutory consequences would otherwise have resulted in payment of tax being postponed, did not, upon the true construction of the Finance Act 1965, constitute a disposal attracting the consequences set out in paragraphs 4 and 6 of Schedule 7 to the Act. That is the first point. The second is that, in reaching that conclusion as a matter of construction, this House did not purport to be doing anything more than applying and

explaining the principle which had been laid down two years previously in *W. T. Ramsay Ltd. v. Inland Revenue Commissioners* [1982] AC 300. It was that decision which explains why and how the question of construction raised in *Furniss v. Dawson* came to be answered in the way that it did and it is, as it seems to me, only if these two considerations are borne in mind that *Furniss v. Dawson* itself can be properly understood or rationally justified as a proper exercise of the judicial function.”

p.504 (before first paragraph)

“the fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. Nor did it decide that the court is entitled, because of the subject's motive in entering into a genuine transaction, to attribute to it a legal effect which it did not have. Both Lord Wilberforce and Lord Fraser of Tullybelton emphasise the continued validity and application of the principle of *Inland Revenue Commissioners v. Duke of Westminster* [1936] AC 1, a principle which Lord Wilberforce described as a “cardinal principle”. What it did decide was that that cardinal principle does not, where it is plain that a particular transaction is but one step in a connected series of interdependent steps designed to produce a single composite overall result, compel the court to regard it as otherwise than what it is, that is to say, merely a part of the composite whole. **In the ultimate analysis, most, if not all, revenue cases depend upon a point of statutory construction, the question in each case being whether a particular transaction or a particular combination of circumstances does or does not fall within a particular formula prescribed by the taxing statute as one which attracts fiscal liability. As part of that process it is, of course, necessary for the courts to identify that which is the relevant transaction or combination before construing and applying to it the statutory formula.** Reduced to its simplest terms that is all that *Ramsay* did. Referring to the Crown's contention Lord Wilberforce observed [1982] A.C. 300, 326:”

p.505 (last paragraph)

“In these circumstances it is easy to understand why and how the conclusion was reached that the appellants had failed to discharge the burden which they had undertaken. Indeed the contrary conclusion would have been surprising. What the case does demonstrate, as it seems to me, is that the

underlying problem is simply one of the construction of the relevant statute and an analysis of the transaction or transactions which are claimed to give rise to the liability or the tax exemption. But it does not follow that because the court, when confronted with a number of factually separate but sequential steps, is not compelled, in the face of the facts, to treat them as if each of them had been effected in isolation, that all sequential steps must invariably be treated as integrated, interdependent and without individual legal effect. Indeed, *Inland Revenue Commissioners v. Plummer* [1980] AC.”

p.508 (first paragraph)

“The suggestion that there should be introduced a moral dimension into the equation is important, however, since it forms the basis of the suggestion implicit in the Crown's submission on the instant appeals that the limits expressed by Lord Brightman in his speech are too narrowly drawn because, when so drawn, “it would be easy for the taxpayer to circumvent them”. **Your Lordships are thus invited not simply to analyse the transaction, to construe the statute and then to apply it to the analysis of what the taxpayer has really done, but to construct a general catch-all formula for rendering ineffective any step undertaken with a view to the avoidance or minimisation of tax on an anticipated transaction or disposition. That is an invitation to legislate** and it goes a very long way beyond what, at any rate, was expressed to be the ratio of *Ramsay* and of *Fumiss v. Dawson* itself, where the emphasis throughout was upon the pre-ordained sequence of the transactions which took place, their dependence upon one another and the necessity of being capable of being construed as one single composite whole. This is graphically underlined in the speech of Lord Russell of Killowen in *Chinn v. Hochstrasser* [1981] AC 533, 550 where he described as a matter “of crucial importance” that “the record on the turntable which was switched on contained the whole story from beginning to end, and there was no provision for switching it off half-way”. It is an aspect of the matter also which emerges clearly from the speeches of Lord Fraser of Tullybelton, Lord Bridge of Harwich and Lord Brightman in *Fumiss v. Dawson* [1984] A.C. 474 itself. Lord Fraser of Tullybelton said, at p.521:

“The true principle of the decision in *Ramsay* was that the fiscal consequences of a pre-ordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series

as a whole, and not by dissecting the scheme and considering each individual transaction separately”.

p.510 (bottom of page) to middle of p.511

“Thirdly, on the footing which I believe to be correct and which I understand to be accepted by all your Lordships, **that the question dealt with in all three of the cases of *Ramsay, Burmah and Furniss* is essentially one of statutory construction, I cannot for my part follow from what principle of statutory construction the proposition for which *Furniss* is now said to be authority derives. Essentially, *Furniss* was concerned with a question which is common to all successive transactions where an actual transfer of property has taken place to a corporate entity which subsequently carries out a further disposition to an ultimate disponent. The question is, “when is a disposal not a disposal within the terms of the statute?” To give to that question the answer, “when, on an analysis of the facts, it is seen in reality to be a different transaction altogether” is well within the accepted canons of construction. To answer it, “when it is effected with a view to avoiding tax on another contemplated transaction” is to do more than simply to place a gloss on the words of the statute. It is to add a limitation or qualification which the legislature itself has not sought to express and for which there is no context in the statute. That, however desirable it may seem, is to legislate, not to construe, and that is something which is not within judicial competence. I can find nothing in *Furniss* or in the cases which preceded it which causes me to suppose that that was what this House was seeking to do. Fourthly, I find myself quite unable to discern any rational basis for the proposition which, if the appellants are to succeed in any of the appeals now before your Lordships, has to be derived from *Furniss* or has to be formulated by your Lordships. The proposition has to be capable of being stated with a degree of certainty before it can be applied. I do not think that it was ever formulated in terms in the appellants’ argument except in so far as it could be deduced from what was submitted to be the result in a number of different hypothetical situations, but, as originally advanced in its widest form, the underlying proposition may be paraphrased thus:**

“In applying a taxing statute to a transaction which is effected with the sole intention of avoiding tax on some other transaction then in view the former is to be treated as having no independent fiscal effect but as a

single indivisible transaction with the latter, if and when the latter takes place.”

Lord Goff: p.520 (first complete paragraph)

“Any idea that the principle in *Ramsay* is a moral principle, or that it is designed to catch any step taken to avoid tax, is, in my opinion, destroyed by the recognition of the *Ramsay* principle as a principle of statutory construction. Indeed the principle cannot be independent of the statute, for the obvious reason that your Lordships have no power to amend the statute. That it is essentially a principle arising from the construction of the statute appears from a number of passages in the speeches in the cases. For example, in *Ramsay* itself [1982] A.C. 300, 326, Lord Wilberforce stated that it was within the judicial function to conclude that there was not such a loss (or gain) as the legislature was dealing with: see also an earlier passage in (*his*) speech in that case, at p. 323. In the same case. Lord Fraser of Tullybelton stated, at p. 339, that he was prepared to dismiss the appeals on the ground that the relevant asset was not disposed of in the sense required by the statute; and in *Inland Revenue Commissioners v. Burmah Oil Co. Ltd.*, 54 T.C. 200, 220, he used language reminiscent of Lord Wilberforce's statement of the law in *Ramsay* (referred to above) to identify the relevant question, which he epitomised as being whether the scheme, when completely carried out, did or did not result in a real loss. But that being so, it follows that tax avoidance schemes are only unacceptable for present purposes if, on a true construction of the statute, they are held to be so.”

Lord Jauncey: p.535 (first complete paragraph)

“I conclude my analysis of the three cases by emphasising that the *Ramsay* principle is a principle of construction, that it does not entitle the courts to legislate at large against specific acts of tax avoidance where Parliament has not done so and that at the end of the day the question will always be whether the event or combination of events relied upon amount to a chargeable transaction or give rise to allowable relief within the meaning of the relevant statutory provisions.”

Ensign Tankers [1992] 1AC 655

Lord Goff: p.682 (first complete paragraph)

“I am prepared (with some hesitation) to accept that the composite transaction which I have just described should not be called a sham, in the narrow sense in which that word has been used in this context. I accept, for example, that title to the negative did, indeed vest in V.P. though the distribution arrangements which formed part of the same composite transaction deprived that legal ownership of any meaningful effect. I accept, too, that money was indeed paid by L.P.I. to V.P. on the various occasions when the relevant account was credited; although that too was deprived of any practical effect by the immediate repayment, on the same day, of exactly the same sum from that account. **What I have to do, however, is to stand back from the composite transaction; to look at it as a whole; and to decide, first, what is the true nature and effect of the transaction and, second, is whether, on a true construction of section 41(1) of the Finance Act 1971, V.P. is entitled to an allowance in respect of the whole of the cost of the film, viz. \$14m.**”

McGuckian [1997] 1 WLR 991

Lord Browne-Wilkinson: p.998 (first full paragraph)

“Finally, Mr. Nugee submitted that the *Ramsay* principle [1982] A.C. 300 only requires the artificial steps inserted for tax purposes to be disregarded if, apart from the *Ramsay* principle, they would have been effective to achieve a tax advantage. My Lords, I emphatically reject this submission. **The approach pioneered in the *Ramsay* case and subsequently developed in later decisions is an approach to construction, viz. that in construing tax legislation, the statutory provisions are to be applied to the substance of the transaction, disregarding artificial steps in the composite transaction or series of transactions inserted only for the purpose of seeking to obtain a tax advantage.** The question is not what was the effect of the insertion of the artificial steps but what was its purpose. Having identified the artificial steps inserted with that purpose and disregarded them, then **what is left is to apply the statutory language of the taxing Act to the transaction carried through stripped of its artificial steps.** It is irrelevant to consider whether or not the disregarded artificial steps would have been effective

to achieve the tax saving purpose for which they were designed.”

Lord Steyn: p.1000 (last complete paragraph)

“The new *Ramsay* principle [1982] A.C. 300 was not invented on a juristic basis independent of statute. That would have been indefensible since a court has no power to amend a tax statute. The principle was developed as a matter of statutory construction. That was made clear by Lord Wilberforce in the *Ramsay* case and is also made clear in subsequent decisions in this line of authority: see the review in the dissenting speech of Lord Goff of Chieveley in *Craven v. White (Stephen)* [1989] A.C. 398, 520B-p. The new development was not based on a linguistic analysis of the meaning of particular words in a statute. It was founded on a broad purposive interpretation, giving effect to the intention of Parliament. The principle enunciated in the *Ramsay* case was therefore based on an orthodox form of statutory interpretation. And in asserting the power to examine the substance of a composite transaction the House of Lords was simply rejecting formalism in fiscal matters and choosing a more realistic legal analysis. Given the reasoning underlying the new approach it is wrong to regard the decisions of the House of Lords since the *Ramsay* case as necessarily marking the limit of the law on tax avoidance schemes”

Lord Cooke: p.1005 (penultimate paragraph of the speech)

“My Lords, this approach to the interpretation of taxing Acts does not depend on general anti-avoidance provisions such as are found in Australasia. Rather, it is antecedent to or collateral with them. In the *Furniss* case [1984] A.C. 474, 527 Lord Brightman spoke of certain limitations (a pre-ordained series of transactions including steps with no commercial or business purpose apart from the avoidance of a liability to tax). The present case does fall within these limitations, but **it may be as well to add that, if the ultimate question is always the true bearing of a particular taxing provision on a particular set of facts, the limitations cannot be universals. Always one must go back to the discernible intent of the taxing Act.** I suspect that advisers of those bent on tax avoidance, which in the end tends to involve an attempt to cast on other taxpayers more than their fair share of sustaining the national tax base, do not always pay sufficient heed to the theme in the speeches in the *Furniss* case, especially those of Lord Scarman, Lord Roskill and Lord Bridge of Harwich, to the effect that the journey's end may not yet have been found. I

will profit from the example of Lord Roskill in the *Furniss* case, at p. 515, by refraining from speculating about whether a sharper focus on the concept of “wages” in the light of the statutory purpose and the circumstances of the case would or would not have led to a different result in the *Duke of Westminster* case [1936] A.C. 1.”

MacNiven [2003] 1 AC 311

Lord Nicholls: p.320, paragraph 8

“8 My Lords, I readily accept that the factual situation described by Lord Brightman is one where, typically, the *Ramsay* approach will be a valuable aid. **In such a situation, when ascertaining the legal nature of the transaction and then relating this to the statute, application of the *Ramsay* approach may well have the effect stated by Lord Brightman. But, as I am sure Lord Brightman would be the first to acknowledge, the *Ramsay* approach is no more than a useful aid. This is not, an area for absolutes. **The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case.** Further, as I have sought to explain, the *Ramsay* case did not introduce a new legal principle. It would be wrong, therefore, to set bounds to the circumstances in which the *Ramsay* approach may be appropriate and helpful. The need to consider a document or transaction in its proper context, and the need to adopt a purposive approach when construing taxation legislation, are principles of general application. Where this leads depends upon the particular set of facts and the particular statute. I have already mentioned where this led in the *Ramsay* case. In *Furniss v Dawson* [1984] AC 474 it led to the conclusion that, within the meaning of the Finance Act 1965, the disposal of shares was in favour of Wood Bastow and not, as the taxpayer contended, in favour of Greenjacket.”**

Lord Hoffmann: p.325, paragraphs 28 and 29

“28 **Everyone agrees that *Ramsay* is a principle of construction.** The House of Lords said so in *Inland Revenue Comrs v McGuckian* [1997] 1 WLR 991. But what is that principle? Mr McCall formulated it as follows in his printed case:

“When a court is asked (i) to apply a statutory provision on which a taxpayer relies for the sake of

establishing some tax advantage (ii) in circumstances where the transaction said to give rise to the tax advantage is, or forms part of, some pre-ordained, circular, self-cancelling transaction (iii) which transaction though accepted as perfectly genuine (i.e. not impeached as a sham) was undertaken for no commercial purpose other than the obtaining of the tax advantage in question then (unless there is something in the statutory provisions concerned to indicate that this rule should not be applied) there is a rule of construction that the condition laid down in the statute for the obtaining of the tax advantage has not been satisfied.”

29 My Lords, I am bound to say that this does not look to me like a principle of construction at all. **There is ultimately only one principle of construction, namely to ascertain what Parliament meant by using the language of the statute.** All other “principles of construction” can be no more than guides which past judges have put forward, some more helpful or insightful than others, to assist in the task of interpretation. But Mr McCall’s formulation looks like an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision, save for the possibility of rebuttal by language which can be brought within his final parenthesis. **This cannot be called a principle of construction except in the sense of some paramount provision subject to which everything else must be read, like section 2(2) of the European Communities Act 1972. But the courts have no constitutional authority to impose such an overlay upon the tax legislation and, as I hope to demonstrate, they have not attempted to do so.**”

p.334, paragraph 58

“58 **The limitations of the *Ramsay* principle therefore arise out of the paramount necessity of giving effect to the statutory language. One cannot elide the first and fundamental step in the process of construction, namely to identify the concept to which the statute refers.** I readily accept that many expressions used in tax legislation (and not only in tax legislation) can be construed as referring to commercial concepts and that the courts are today readier to give them such a construction than they were before the *Ramsay* case. But that is not always the case. Taxing statutes often refer to purely legal concepts. They use expressions of which a commercial man,

asked what they meant, would say “You had better ask a lawyer”. For example, stamp duty is payable upon a “conveyance or transfer on sale”: see Schedule 13, paragraph 1(1) to the Finance Act 1999. Although slightly expanded by a definition in paragraph 1(2), the statutory language defines the document subject to duty essentially by reference to external legal concepts such as “conveyance” and “sale”. If a transaction falls within the legal description, it makes no difference that it has no business purpose. Having a business purpose is not part of the relevant concept. If the “disregarded” steps in *Furniss v Dawson* [1984] AC 474 had involved the use of documents of a legal description which attracted stamp duty, duty would have been payable.”

Lord Hope:

p.340, paragraph 77

“77 The transaction with which your Lordships are concerned in this case, when taken as a whole, has an odd aspect and it invites careful scrutiny. The movement of funds from the Electricity Supply Pension Scheme to WIL, which it owned, as capital and back again to the Scheme as interest was undoubtedly circular. And each step in the transaction was obviously pre-ordained. Its purpose was to create a tax benefit to WIL without any loss to the scheme, which was exempt from income tax. But for the exempt status which the scheme enjoyed, the lender would have had to bear tax on the interest paid to it by WIL. For this reason the capital which WIL was able to obtain from the scheme was unlikely to have been available to it from another source. **Nevertheless the question which has to be resolved depends on the meaning of the words used in the statute which are said to allow the deduction. It is one of statutory interpretation. I would approach it without any preconceived notions as to whether this is a case of tax mitigation or of tax avoidance. The only 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?”**

Shiu Wing [2000] HKCFA

Litton PJ:

“It is necessary at the outset to emphasise, as Lord Steyn said in *IRC v McGuckian* [1997] STC 908 at 916e, that the *Ramsay*

principle is not invented on a juristic basis independent of statute: "That would have been indefensible since a court has no power to amend a tax statute. The principle was developed as a matter of statutory construction"."

Sir Anthony Mason NPJ:

"The principle, according to the House of Lords, is both a rule of statutory construction applicable to revenue statutes and an approach to the analysis of the facts. At first instance, Findlay J. had difficulty in seeing the principle as a rule of construction. His Lordship considered that it was in truth a way of viewing or, as I would express it, a way of analysing the facts. This element of the *Ramsay* principle may be expressed by saying that where there is a single pre-ordained, composite transaction intended to be carried out in its entirety, the court is not compelled for tax purposes to ignore its composite character and to break it up into its individual constituent steps so that the statute is then applied to those individual steps separately. If the purpose of intermediate steps in the composite transaction was fiscal they may be disregarded. The composite transaction may then have consequences which bring it within a charging provision of the statute."

Arrowtown

Ribeiro PJ:

p.12, paragraph 31

"31. The opposing, and in my respectful opinion, preferable, view is that the ***Ramsay* principle does not espouse any specialised principle of statutory construction applicable to tax legislation, whatever its language, but continues to assert the need to apply orthodox methods of purposive interpretation to the facts viewed realistically.** In common with Lord Hoffmann in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311 at para 49, I am of the view that Lord Brightman's formulation is not a principle of construction, but, as stated above, a decision that the Court is entitled, for fiscal purposes, to disregard intermediate steps having no commercial purpose *as a consequence of* an orthodox exercise of purposive statutory construction."

 Lord Millett NPJ:

p.42, paragraph 105

“105. In *Shiu Wing Ltd v. Commissioner for Estate Duty* Sir Anthony Mason NPJ (at p.240) explained that the approach adopted by the House of Lords in *Ramsay*, which he observed accords with the basic legal principle adopted in the United States, **is both a rule of statutory construction and an approach to the analysis of the facts.** These two aspects of the principle have been present from the start. **The doctrine cannot but involve an approach to statutory construction. It is a fundamental principle** of the constitution of Hong Kong, as of the United Kingdom and the United States, **that the subject is to be taxed by the legislature and not by the courts. In all three jurisdictions, therefore, every tax case, that is to say every question of tax or no tax, is ultimately a question of statutory construction. The question is always whether what the taxpayer did was within the intendment of the particular statutory provision which is invoked. Before construing the statute and applying it to the facts, however, it is first necessary to analyse what the taxpayer did.”**

p.57 paragraph 143

“143. But the basis of the decision is that, even if the payment in question was undertaken solely for the purpose of obtaining tax relief, **the granting of such relief in such circumstances was nevertheless within the intendment of the statute.** The importance of the case is that the no business purpose test is not a free-standing principle which yields an automatic solution in every case. It is rather a manifestation of a purposive construction of the relevant statutory provision, and even transactions undertaken for the sole purpose of obtaining relief from tax may be within the intendment of the statute. There is no alternative to a careful consideration of the reasons which motivated the legislature to impose the tax or to grant the relief in question.”

^B *IRC v Duke of Westminster* [1936] AC 1

Lord Macmillan:

p.27 (last paragraph)

“My Lords, I venture to suggest that the proper approach to the problem is to ask the question, in the language of Rule 1 applicable to Case III. of Sch. D: Is the 38s a week of the nature of an annual payment payable by the respondent as a personal

debt or obligation by virtue of a contract? Plainly it is, and none the less so because of the collateral arrangement which, whatever it does, does not convert the deed of covenant into a contract of employment, for the 38s remains payable, employment or no employment. It is agreed that if Allman leaves the respondent's employment the weekly payments which he will continue to receive under the deed will fall within Rule 1 applicable to Case III. of Sch. D. But the payments made to him while he remains in the respondent's employment are exigible by him under precisely the same legal obligation on the part of the respondent. If then the question which I have put must be answered in the affirmative, Rule 19, sub-s. 1, of the Rules applicable to all Schedules automatically applies and the respondent is entitled to deduct tax on making the covenanted payments to Allman, and if he is entitled to deduct tax from the payments he is also entitled to deduct the amount of these payments in computing his total income for surtax purposes. The same reasoning is applicable to the respondent's transactions with his other employees, except that in the case of Mr. Blow there was only a deed of covenant and no collateral letters. His case is consequently a fortiori of the others."

MacNiven [2003] 1 AC 311

Lord Nicholls:

p.319 paragraph 5

"5 Third, having identified the legal nature of the transaction, the courts must then relate this to the language of the statute. For instance, if the scheme has the apparently magical result of creating a loss without the taxpayer suffering any financial detriment, is this artificial loss a loss *within the meaning of the relevant statutory provision*? Thus, in *Ramsay* the taxpayer company sought to create an allowable loss to offset against a chargeable gain it had made on a sale-leaseback transaction. It sought to do so without suffering any financial detriment, by embarking on and carrying through a scheme which created both a loss which was allowable for tax purposes and a matching gain which was not chargeable. In rejecting the efficacy of this contrived "loss-creating" scheme, Lord Wilberforce [1982] AC 300, 326, observed that a loss which comes and goes as part of a pre-planned, single continuous operation "is not such a loss (or gain) as the legislation is dealing with". In *Inland Revenue Comrs v Burmah Oil Co Ltd* [1982] STC 30, 37 Lord Fraser of Tullybelton described this passage as the ratio of the decision in the *Ramsay* case."

Lord Hoffmann:

p.326 paragraph 30 (third line)

“30 As is well known, the *Ramsay* case [1982] AC 300 was concerned with a tax avoidance scheme designed to manufacture a capital loss to set off against a capital gain. **The question before the House was whether a transaction by which the taxpayer company acquired certain shares for £185,034 and almost immediately sold them for £9,387, gave rise to a “loss accruing on a disposal of an asset” within the meaning of section 23(1) of the Finance Act 1965.** Both the acquisition and sale of the shares formed part of a pre-planned series of transactions by which the alleged loss was exactly balanced by a gain which was alleged to fall within an exemption from the charge. The aggregate effect was that the taxpayer suffered no loss except the payment of a fee to the promoters of the scheme.”

p.330 paragraph 43 (first line)

“43 The *Burmah* case also concerned the **question of whether the company had suffered a loss for the purposes of capital gains tax.** As in the *Ramsay* case, it had produced a loss by a circular series of transactions which had no business purpose. A subsidiary owed it a substantial sum which it could not repay. As a bad debt on capital account, this would not have been an allowable loss. *Burmah* therefore invested the same amount in shares in the subsidiary, which used the money to repay the debt and then went into liquidation. *Burmah* recovered nothing on its share investment and claimed that it had thereby suffered a loss. The House of Lords held that this was not a loss caused by a disposal within the meaning of the Act. The transaction left *Burmah* no worse off than it had been before and merely purported to convert a bad debt into an allowable loss.”

p.331, paragraph 46

“46 **Thus, while the question in the *Ramsay* case [1982] AC 300 had been whether there was a disposal giving rise to a loss, the question in the *Furniss* case was whether the disposal had been to one person rather than another.** But the House decided that the *Ramsay* construction, involving, as I have said, a commercial characterisation of the relevant concept, could be equally applied to the latter question. *Greenjacket* was merely an artificially introduced intermediate party which was never intended to own the shares for more than an instant. Commercially, therefore, the transaction was a transfer by the

Dawsons to Wood Bastow in exchange for a payment to Greenjacket. In answering the statutory question: "To whom was the disposal made?" the fact that the shares were routed through Greenjacket was irrelevant."

p.333, paragraph 54

"54 It seems to me that the Crown caused unnecessary difficulties for itself in the *McGuckian* case by failing to notice that the question was different from that in *Furniss v Dawson* and therefore did not necessarily respond to precisely the same analysis. In the *Furniss* case the question was the identity of the donee. In the *McGuckian* case it was the nature of the payment received by Shurltrust – capital or income? In the former case, it is reasonable to speak of the middle stage of a chain of disposals being "disregarded". In the latter case, it makes much less sense. **The question was not whether the assignment should be disregarded but whether, from a commercial point of view, it amounted to an exchange of income for capital.** Such exchanges usually have a commercial reality: the purchase or sale of an annuity, for example, is an exchange of capital for an income stream, involving a transfer of risk. But the transaction in the *McGuckian* case was nothing more than an attempt to relabel a sum of money. The fact that the assignment had no commercial purpose did not mean that it had to be disregarded. But it failed to perform the alchemy of transforming the receipt of a dividend from the company into the receipt of a capital sum from someone else. **For the purpose of the fiscal concept at stake, namely the character of the receipt as income derived from the company, it made no difference.**"

Lord Hope:

p.340, paragraph 77

"77 The transaction with which your Lordships are concerned in this case, when taken as a whole, has an odd aspect and it invites careful scrutiny. The movement of funds from the Electricity Supply Pension Scheme to WIL, which it owned, as capital and back again to the Scheme as interest was undoubtedly circular. And each step in the transaction was obviously pre-ordained. Its purpose was to create a tax benefit to WIL without any loss to the scheme, which was exempt from income tax. But for the exempt status which the scheme enjoyed, the lender would have had to bear tax on the interest paid to it by WIL. For this reason the capital which WIL was able to obtain from the scheme was unlikely to have been available to it from another source.

Nevertheless the question which has to be resolved depends on the meaning of the words used in the statute which are said to /allow the deduction. It is one of statutory interpretation. I would approach it without any preconceived notions as to whether this is a case of tax mitigation or of tax avoidance. **The only 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?"

p.341, paragraph 80

"80 The question that has to be addressed in these circumstances relates, as Lord Steyn said in *Inland Revenue Comrs v McGuckian* [1997] 1 WLR 991, 1001G, **to the fiscal effectiveness of the transaction entered into by the taxpayer. The answer to the question is to be found in the words used by the statute.** A course of action that was designed to defeat the intention of Parliament would fall to be treated as tax avoidance and dealt with accordingly. **But one must discover first what the statute means. The ordinary principles of statutory construction must then be applied to the words used by Parliament which describe the effect of the transaction for tax purposes."**

^C *MacNiven* [2003] 1 AC 311

Lord Nicholls:

p.320, paragraph 8

"8 My Lords, I readily accept that the factual situation described by Lord Brightman is one where, typically, the *Ramsay* approach will be a valuable aid. In such a situation, when ascertaining the legal nature of the transaction and then relating this to the statute, application of the *Ramsay* approach may well have the effect stated by Lord Brightman. But, as I am sure Lord Brightman would be the first to acknowledge, the *Ramsay* approach is no more than a useful aid. This is not an area for absolutes. The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case. Further, as I have sought to explain, the *Ramsay* case did not introduce a new legal principle. It would be wrong, therefore, to set bounds to the circumstances in which the *Ramsay* approach may be appropriate and helpful. **The need to consider a document or transaction in its proper context, and the need**

to adopt a purposive approach when construing taxation legislation, are principles of general application. Where this leads depends upon the particular set of facts and the particular statute. I have already mentioned where this led in the *Ramsay* case. In *Furniss v Dawson* [1984] AC 474 it led to the conclusion that, within the meaning of the Finance Act 1965, the disposal of shares was in favour of Wood Bastow and not, as the taxpayer contended, in favour of Greenjacket.”

Lord Hoffman:

p.327, paragraph 32

“32 My Lords, it is worth pausing at this point to examine the characteristically compressed reasoning in a little more detail. A loss which arises at one stage of an indivisible process and cancelled out at a later stage of the same process is “not such a loss as the legislation is dealing with”. The tax was not imposed “on arithmetical differences”. In that case, what kind of loss was the legislation dealing with? The contrast being made throughout Lord Wilberforce's speech is between juristic or arithmetical realities on the one hand and commercial realities on the other. **He is construing the words "disposal" and "loss" to refer to commercial concepts which are not necessarily confined by the categories of juristic analysis.** In the *Ramsay* case [1982] AC 300, a director, or an accountant concerned to present a true and fair view of the taxpayer's dealings, would not have said that the company had entered into a transaction giving rise to a loss which happened to have been offset by a corresponding gain. There had never been any commercial possibility that the transactions would not have cancelled each other out. Therefore, notwithstanding the juristic independence of each of the stages of the circular transaction, the commercial view would have been to lump them all together, as the parties themselves intended, and describe them as a composite transaction which had no financial consequences. The innovation in the *Ramsay* case was to give the statutory concepts of “disposal” and “loss” a commercial meaning. **The new principle of construction was a recognition that the statutory language was intended to refer to commercial concepts, so that in the case of a concept such as a “disposal”, the court was required to take a view of the facts which transcended the juristic individuality of the various parts of a preplanned series of transactions.**”

p.333, paragraph 54

“54 **It seems to me that the Crown caused unnecessary**

difficulties for itself in the *McGuckian* case by failing to notice that the question was different from that in *Furniss v Dawson* and therefore did not necessarily respond to precisely the same analysis. In the *Furniss* case the question was the identity of the disponent. In the *McGuckian* case it was the nature of the payment received by Shurltrust – capital or income? In the former case, it is reasonable to speak of the middle stage of a chain of disposals being "disregarded". In the latter case, it makes much less sense. The question was not whether the assignment should be disregarded but whether, from a commercial point of view, it amounted to an exchange of income for capital. Such exchanges usually have a commercial reality: the purchase or sale of an annuity, for example, is an exchange of capital for an income stream, involving a transfer of risk. But the transaction in the *McGuckian* case was nothing more than an attempt to relabel a sum of money. The fact that the assignment had no commercial purpose did not mean that it had to be disregarded. But it failed to perform the alchemy of transforming the receipt of a dividend from the company into the receipt of a capital sum from someone else. For the purpose of the fiscal concept at stake, namely the character of the receipt as income derived from the company, it made no difference."

p.334, paragraph 58

"58 The limitations of the *Ramsay* principle therefore arise out of the paramount necessity of giving effect to the statutory language. One cannot elide the first and fundamental step in the process of construction, namely to identify the concept to which the statute refers. I readily accept that many expressions used in tax legislation (and not only in tax legislation) can be construed as referring to commercial concepts and that the courts are today readier to give them such a construction than they were before the *Ramsay* case. But that is not always the case. **Taxing statutes often refer to purely legal concepts. They use expressions of which a commercial man, asked what they meant, would say "You had better ask a lawyer". For example, stamp duty is payable upon a "conveyance or transfer on sale":** see Schedule 13, paragraph 1(1) to the Finance Act 1999. Although slightly expanded by a definition in paragraph 1(2), **the statutory language defines the document subject to duty essentially by reference to external legal concepts such as "conveyance" and "sale". If a transaction falls within the legal description, it makes no difference that it has no business purpose. Having a business purpose is not part of the relevant concept.** If the "disregarded" steps in *Furniss v Dawson* [1984] AC 474 had

involved the use of documents of a legal description which attracted stamp duty, duty would have been payable.”

Lord Hope:

p340, paragraphs 77 and 78

“77 The transaction with which your Lordships are concerned in this case, when taken as a whole, has an odd aspect and it invites careful scrutiny. The movement of funds from the Electricity Supply Pension Scheme to WIL, which it owned, as capital and back again to the Scheme as interest was undoubtedly circular. And each step in the transaction was obviously pre-ordained. Its purpose was to create a tax benefit to WIL without any loss to the scheme, which was exempt from income tax. But for the exempt status which the scheme enjoyed, the lender would have had to bear tax on the interest paid to it by WIL. For this reason the capital which WIL was able to obtain from the scheme was unlikely to have been available to it from another source. Nevertheless the question which has to be resolved depends on the meaning of the words used in the statute which are said to allow the deduction. **It is one of statutory interpretation. I would approach it without any preconceived notions as to whether this is a case of tax mitigation or of tax avoidance. The only 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?**

78 Section 338(1) of the Income and Corporation Taxes Act 1988 provides that there shall be allowed as deductions for the relevant accounting period “any charges on income paid by the company in the accounting period, so far as paid out of the company’s profits brought into charge to corporation tax”. Subsection (2)(a) of that section provides that “charges on income” means for the purposes of corporation tax “payments” of any description mentioned in subsection (3). Subsection (3)(a) states that the payments referred to in subsection (2) include “any yearly interest”. **Those are the provisions on which WIL’s claim to an allowable deduction in the end depends. There is no question in this case of the taxpayer having to demonstrate that it has sustained a “loss” or achieved a “gain” in circumstances where the result of the transaction was to leave it in no different position from that which it was in before. Had that been the question, the issue, as in *W T Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300, would have been whether at the end of the day there was a real loss or a real**

gain. But those are not the concepts which are used in the statutory provisions that are in issue in this case. They do not depend upon an assessment of the result of the transaction. They depend upon the taxpayer being able to demonstrate that a charge on income has been “paid” by the company.”

^D *MacNiven* [2003] 1 AC 311

Lord Hoffmann: p.334, paragraph 58

“58 The limitations of the *Ramsay* principle therefore arise out of the paramount necessity of giving effect to the statutory language. One cannot elide the first and fundamental step in the process of construction, namely to identify the concept to which the statute refers. I readily accept that many expressions used in tax legislation (and not only in tax legislation) can be construed as referring to commercial concepts and that the courts are today readier to give them such a construction than they were before the *Ramsay* case. But that is not always the case. Taxing statutes often refer to purely legal concepts. They use expressions of which a commercial man, asked what they meant, would say “You had better ask a lawyer”. For example, stamp duty is payable upon a “conveyance or transfer on sale”: see Schedule 13, paragraph 1(1) to the Finance Act 1999. Although slightly expanded by a definition in paragraph 1(2), the statutory language defines the document subject to duty essentially by reference to external legal concepts such as “conveyance” and “sale”. If a transaction falls within the legal description, it makes no difference that it has no business purpose. Having a business purpose is not part of the relevant concept. If the “disregarded” steps in *Furniss v Dawson* [1984] AC 474 had involved the use of documents of a legal description which attracted stamp duty, duty would have been payable.”

Gregory v. Helvering 69 F2d 809

Judge Learned Hand: p.2 (right hand column)

“It is quite true, as the Board has very well said, that as the articulation of a statute increases, the room for interpretation must contract; but the meaning of a sentence may be more than that of the separate words, as a melody is more than the notes, and no degree of particularity can ever obviate

recourse to the setting in which all appear, and which all collectively create.”

^E *W.T. Ramsay Ltd v IRC* [1982] AC 300

Lord Wilberforce:p.323 (first full paragraph) to end of paragraph on p324

“In these circumstances, your Lordships are invited to take, with regard to schemes of the character I have described, what may appear to be a new approach. We are asked, in fact, to treat them as fiscally, a nullity, not producing either a gain or a loss. Mr. Potter Q.C. described this as revolutionary, so I think it opportune to restate some familiar principles and some of the leading decisions so as to show the position we are now in.

1. A subject is only to be taxed upon clear words, not upon “intendment” or upon the “equity” of an Act. Any taxing Act of Parliament is to be construed in accordance with this principle. What are “clear words” is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded: see *Inland Revenue Commissioners v. Wesleyan and General Assurance Society* (1946) 30 T.C. 11, 16 per Lord Greene M.R. and *Mangin v. Inland Revenue Commissioner* [1971] A.C. 739, 746, per Lord Donovan. The relevant Act in these cases is the Finance Act 1965, the purpose of which is to impose a tax on gains less allowable losses, arising from disposals.

2. A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. It must be considered according to its legal effect.

3. It is for the fact-finding commissioners to find whether a document, or a transaction, is genuine or a sham. In this context to say that a document or transaction is a “sham” means that while professing to be one thing, it is in fact something different. To say that a document or transaction is genuine, means that, in law, it is what it professes to be, and it does not mean anything more than that. I shall return to this point.

Each of these three principles would be fully respected by the decision we are invited to make. Something more must be said as to the next principle.

4. Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance. This is the well-known principle of *Inland Revenue Commissioners v. Duke of Westminster* [1936] A.C. 1. This is a cardinal principle but it must not be overstated or overextended. While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the "court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded: to do so is not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded. For this there is authority in the law relating to income tax and capital gains tax: see *Chinn v. Hochstrasser* [1981] AC 533 and *Inland Revenue Commissioners v. Plummer* [1980] AC 896."

Craven v White [1989] AC 398

Lord Oliver:p.503 to p.504 (paragraph beginning at end of p.503)

"It is equally important to bear in mind what the case did not decide. It did not decide that a transaction entered into with the motive of minimising the subject's burden of tax is, for that reason, to be ignored or struck down. Lord Wilberforce, at p. 323, was at pains to stress that the fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. Nor did it decide that the court is entitled, because of the subject's motive in entering into a genuine transaction, to attribute to it a legal effect which it did not have. Both Lord Wilberforce and Lord Fraser of Tullybelton emphasise the continued validity and application of the principle of *Inland Revenue Commissioners v. Duke of Westminster* [1936] A.C. 1, a principle which Lord Wilberforce described as a "cardinal principle". What it did

decide was that that cardinal principle does not, where it is plain that a particular transaction is but one step in a connected series of interdependent steps designed to produce a single composite overall result, compel the court to regard it as otherwise than what it is, that is to say, merely a part of the composite whole. In the ultimate analysis, most, if not all, revenue cases depend upon a point of statutory construction, the question in each case being whether a particular transaction or a particular combination of circumstances does or does not fall within a particular formula prescribed by the taxing statute as one which attracts fiscal liability. As part of that process it is, of course, necessary for the courts to identify that which is the relevant transaction or combination before construing and applying to it the statutory formula. Reduced to its simplest terms that is all that *Ramsay* did. Referring to the Crown's contention Lord Wilberforce observed [1982] A.C. 300, 326:

“That does not introduce a new principle: it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation”.”

McGuckian [1997] 1 WLR 991

Lord Steyn:

p.1000 (first full paragraph)

“But that left the problem of the courts’ self-denying ordinance of not examining the true nature of a composite transaction. Lord Wilberforce observed, at p. 323H, that the *Duke of Westminster* case [1936] A.C. 1, did not compel the court to look at documents or transactions in blinkers, isolated from the context in which they properly belong. Lord Wilberforce concluded, at p. 326:

“While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still. Such immobility must result either in loss of tax, to the prejudice of other taxpayers, or to Parliamentary congestion or (most likely) to both. To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process. In each case the facts must be established, and a legal analysis made: legislation

cannot be required or even be desirable to enable the courts to arrive at a conclusion which corresponds with the parties' own intentions."

In other words, if it was shown that a scheme was intended to be implemented as a whole, legal analysis permitted the court in deciding a fiscal question to take into account the composite transaction."

^F *IRC v Duke of Westminster* [1936] AC 1

Lord Tomlin: p.19 (last paragraph on page)

"Apart, however, from the question of contract with which I have dealt, **it is said that in revenue cases** there is a doctrine that the Court may ignore the legal position and regard what is called "the substance of the matter", and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages, and that therefore, while he is so serving, **the annuity must be treated as salary or wages**. This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled, and the supposed doctrine given its quietus, the better it will be for all concerned, for **the doctrine seems to involve substituting "the incertain and crooked cord of discretion" for "the golden and straight metwand of the law"**. (1) Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. **This so-called doctrine of "the substance" seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.**"

Lord Russell of Killowen: p.25

"On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. **If all that is meant by the**

doctrine is that having once ascertained the legal rights of the parties you may disregard mere nomenclature and decide the question of taxability or non-taxability in accordance with the legal rights, well and good. That is what this House did in the case of *Secretary of State in Council of India v. Scoble (I)*; that and no more. **If, on the other hand, the doctrine means that you may brush aside deeds, disregard the legal rights and liabilities arising under a contract between parties, and decide the question of taxability or non-taxability upon the footing of the rights and liabilities of the parties being different from what in law they are, then I entirely dissent from such a doctrine.**

The substance of the transaction between Allman and the Duke is in my opinion to be found and to be found only by ascertaining their respective rights and liabilities under the deed, the legal effect of which is what I have already stated."

Lord Macmillan:

p.27 (first full paragraph)

"Allman has, I understand, remained in the respondent's service and receives in fact the same sum of money weekly from the respondent as he received before the transaction in question. Has that sum to the extent of 38s altered its legal character in consequence of the transaction? In my opinion it has. Whereas previously Allman was entitled to the 38s a week as wages, he is now entitled to payment of this sum weekly whether he is employed by the respondent or not. That is the effect of the deed of covenant. The arrangement embodied in the two collateral documents does not alter that effect, whatever else it does. **It is difficult to see how a sum which is payable irrespective of employment can be said to be a profit arising from employment.** If the collateral documents had affected the absolute and independent nature of the obligation under the deed of covenant different considerations might have arisen. **But the absolute obligation to pay irrespective of employment remains unaffected by the collateral documents, which recognize that Allman will in future have an unqualified right to a weekly payment of 38s from the respondent whether the respondent employs him or not."**

Lord Wright:

p.31 (last paragraph)

"I may add that I do not understand what is meant by the expression "payments for continuing service ejusdem generis

with wages or salaries”. **The payments must be one thing or the other, either annual payments or wages; there is no room for anything intermediate or in the nature of cy-près. And once it is admitted that the deed is a genuine document, there is in my opinion no room for the phrase “in substance”. Or, more correctly, the true nature of the legal obligation and nothing else is “the substance”.** I need not develop this point, as I agree with what has been said by my noble and learned friends, Lord Tomlin and Lord Russell of Killowen.”

^G *MacNiven* [2003] 1 AC 311

Lord Nicholls:

p.318, paragraph 1

“On this appeal the Inland Revenue Commissioners pray in aid what is loosely called the *Ramsay* principle. This is a reference to the decision in *W T Ramsay Ltd v Inland Revenue Comrs* [1982,] AC 300. So it is necessary first to remind oneself what the House decided in that case. **An initial point to note is that the very phrase “the *Ramsay* principle” is potentially misleading. In the *Ramsay* case the House did not enunciate any new legal principle. What the House did was to highlight that, confronted with new and sophisticated tax avoidance devices, the courts’ duty is to determine the legal nature of the transactions in question and then relate them to the fiscal legislation: see Lord Wilberforce, at p.326.”**

p.320, paragraph 8

“My Lords, I readily accept that the factual situation described by Lord Brightman is one where, typically, the *Ramsay* approach will be a valuable aid. In such a situation, when ascertaining the legal nature of the transaction and then relating this to the statute, application of the *Ramsay* approach may well have the effect stated by Lord Brightman. **But, as I am sure Lord Brightman would be the first to acknowledge, the *Ramsay* approach is no more than a useful aid. This is not, an area for absolutes.** The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case. **Further, as I have sought to explain, the *Ramsay* case did not introduce a new legal principle.** It would be wrong, therefore, to set bounds to the circumstances in which the *Ramsay* approach may be appropriate and helpful. The need to consider a document or transaction in its proper context, and the need to adopt a purposive approach when construing taxation legislation,

are principles of general application. Where this leads depends upon the particular set of facts and the particular statute. I have already mentioned where this led in the *Ramsay* case. In *Furniss v Dawson* [1984] AC 474 it led to the conclusion that, within the meaning of the Finance Act 1965, the disposal of shares was in favour of Wood Bastow and not, as the taxpayer contended, in favour of Greenjacket.”

Arrowtown

Ribeiro PJ: p.12, paragraph 31

“31. The opposing, and in my respectful opinion, preferable, view is that the *Ramsay* principle does not espouse any specialised principle of statutory construction applicable to tax legislation, whatever its language, but continues to assert the need to apply orthodox methods of purposive interpretation to the facts viewed realistically. In common with Lord Hoffmann in *MacNiven v Westmoreland Investments Ltd* [2003] 1 AC 311 at para 49, I am of the view that Lord Brightman” formulation is not a principle of construction, but, as stated above, a decision that the Court is entitled, for fiscal purposes, to disregard intermediate steps having no commercial purpose *as a consequence of* an orthodox exercise of purposive statutory construction.”

^H *Craven v White* [1989] AC 398

Lord Oliver: p.508 (first paragraph)

“The suggestion that there should be introduced a moral dimension into the equation is important, however, since it forms the basis of the suggestion implicit in the Crown's submission on the instant appeals that the limits expressed by Lord Brightman in his speech are too narrowly drawn because, when so drawn, "it would be easy for the taxpayer to circumvent them." Your Lordships are thus invited not simply to analyse the transaction, to construe the statute and then to apply it to the analysis of what the taxpayer has really done, but to construct a general catch-all formula for rendering ineffective any step undertaken with a view to the avoidance or minimisation of tax on an anticipated transaction or disposition. That is an invitation to legislate and it goes a very long way beyond what, at any rate, was

expressed to be the ratio of *Ramsay* and of *Fumiss v. Dawson* itself, where the emphasis throughout was upon the pre-ordained sequence of the transactions which took place, their dependence upon one another and the necessity of being capable of being construed as one single composite whole. This is graphically underlined in the speech of Lord Russell of Killowen in *Chinn v Hochstrasser* [1981] A.C. 533, 550 where he described as a matter “of crucial importance” that “the record on the turntable which was switched on contained the whole story from beginning to end, and there was no provision for switching it off half-way”. It is an aspect of the matter also which emerges clearly from the speeches of Lord Fraser of Tullybelton, Lord Bridge of Harwich and Lord Brightman in *Fumiss v Dawson* [1984] A.C. 474 itself. Lord Fraser of Tullybelton said, at p. 521:

“The true principle of the decision in *Ramsay* was that the fiscal consequences of a pre-ordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole, and not by dissecting the scheme and considering each individual transaction separately.”

p.515 (last complete paragraphs) to p. 516 (first end of paragraph)

“My Lords, I do not think so. I am at one with those of your Lordships who find the complicated and stylised antics of the tax avoidance industry both unedifying and unattractive but **I entirely dissent from the proposition that because there is present in each of the three appeals before this House the element of a desire to mitigate or postpone the respondents' tax burdens, this fact alone demands from your Lordships a predisposition to expand the scope of the doctrine of *Ramsay* and of *Furniss v. Dawson* beyond its rational basis in order to strike down a transaction which would not otherwise realistically fall within it.**

Nor do I consider that the *Ramsay* approach, which is no doubt applicable to a much wider variety of transactions than those embraced in the instant appeals, requires further exposition or clarification. Its basis is manifest and has been clearly explained by Lord Wilberforce. **What the appellants urge upon your Lordships is a restatement of the approach in a formula based, as it seems to me, not upon seeking to identify the reality of sequential transactions, but upon a much wider, but**

at the moment undefined, general principle of judicial disapprobation of the lawful rearrangement of the subject's affairs designed to produce a result which is fiscally advantageous to him in relation to a transaction into which he anticipates entering. That is essentially a legislative exercise and one upon which, in my opinion, your Lordships should hesitate long before embarking."

McGuckian [1997] 1 WLR 991

Lord Steyn: p.1000 (last complete paragraph)

"The new *Ramsay* principle [1982] A.C. 300 was not invented on a juristic basis independent of statute. That would have been indefensible since a court has no power to amend a tax statute. The principle was developed as a matter of statutory construction. That was made clear by Lord Wilberforce in the *Ramsay* case and is also made clear in subsequent decisions in this line of authority: see the review in the dissenting speech of Lord Goff of Chieveley in *Craven v. White (Stephen)* [1989] A.C. 398, 520B-p. The new development was not based on a linguistic analysis of the meaning of particular words in a statute. It was founded on a broad purposive interpretation, giving effect to the intention of Parliament. The principle enunciated in the *Ramsay* case was therefore based on an orthodox form of statutory interpretation. And in asserting the power to examine the substance of a composite transaction the House of Lords was simply rejecting formalism in fiscal matters and choosing a more realistic legal analysis. Given the reasoning underlying the new approach it is wrong to regard the decisions of the House of Lords since the *Ramsay* case as necessarily marking the limit of the law on tax avoidance schemes."

MacNiven [2003] 1 AC 311 (A3)

Lord Hoffman: p.325, paragraph 29

"29 My Lords, I am bound to say that this does not look to me like a principle of construction at all. There is ultimately only one principle of construction, namely to ascertain what Parliament meant by using the language of the statute. All other "principles of construction" can be no more than guides which past judges have put forward, some more helpful or insightful than others, to assist in the task of interpretation. But Mr McCall's formulation

looks like an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision, save for the possibility of rebuttal by language which can be brought within his final parenthesis. This cannot be called a principle of construction except in the sense of some paramount provision subject to which everything else must be read, like section 2(2) of the European Communities Act 1972. **But the courts have no constitutional authority to impose such an overlay upon the tax legislation and, as I hope to demonstrate, they have not attempted to do so.**"

p.335/6, paragraph 62

"62 My Lords, it has occasionally been said that the boundary of the *Ramsay* principle can be defined by asking whether the taxpayer's actions constituted (acceptable) tax mitigation or (unacceptable) tax avoidance. In *Inland Revenue Comrs v Willoughby* [1997] 1 WLR 1071, 1079 Lord Nolan described the concept of tax avoidance as "elusive". In that case, the House had to grapple with what it meant, or at any rate what its "hallmark" was, because the statute expressly provided that certain provisions should not apply if the taxpayer could show that he had not acted with "the purpose of avoiding liability to taxation". The same question arises on the interpretation of the anti-avoidance provisions to which Lord Cooke of Thorndon referred in *Inland Revenue Comrs v McGuckian* [1997] 1 WLR 991, 1005. **But when the statutory provisions do not contain words like "avoidance" or "mitigation", I do not think that it helps to introduce them. 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. If I may be allowed to repeat what I said in *Norglen Ltd v Reeds Rains Prudential Ltd* [1999] 2 AC 1, 13-14:**

"If the question is whether a given transaction is such as to attract a statutory benefit, such as a grant or assistance like legal aid, or a statutory burden, such as income tax, I do not think that it promotes clarity of thought to use terms like stratagem or device. The question is simply whether upon its true construction, the statute applies to the transaction. Tax avoidance schemes are perhaps the best example. They either work (*Inland Revenue Comrs v Duke of Westminster* [1936] AC 1) or they do not (*Furniss v Dawson*

[1984] AC 474). If they do not work, the reason, as my noble and learned friend, Lord Steyn, pointed out in *Inland Revenue Comrs v McGuckian* [1997] 1 WLR 991, 1000, is simply that upon the true construction of the statute, the transaction which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes.”

¹ *Burmah Oil* [1982] STC 30

Lord Diplock:

at p.32 h

“The *Duke of Westminster*’s case was about a simple transaction entered into between two real persons each with a mind of his own, the Duke and his gardener, even though in the nineteen-thirties and at a time of high unemployment there might be reason to expect that the mind of the gardener would manifest some degree of subservience to that of the Duke. **The kinds of tax-avoidance schemes that have occupied the attention of the courts in recent years, however, involve inter-connected transactions between artificial persons, limited companies, without minds of their own but directed by a single master-mind. In *Ramsay* the master-mind was the deviser and vendor of the tax-avoidance scheme; in the instant case it was *Burmah*, the parent company of the wholly-owned subsidiary companies between which the pre-ordained series of transactions took place.**”

MacNiven [2003] 1 AC 311 (A3)

Lord Nicholls:

p.318/9, paragraphs 1 to 5

“1 On this appeal the Inland Revenue Commissioners pray in aid what is loosely called the *Ramsay* principle. This is a reference to the decision in *W T Ramsay Ltd v Inland Revenue Comrs* [1982.] AC 300. So it is necessary first to remind oneself what the House decided in that case. An initial point to note is that the very phrase “the *Ramsay* principle” is potentially misleading. In the *Ramsay* case the House did not enunciate any new legal principle. **What the House did was to highlight that, confronted with new and sophisticated tax avoidance devices, the courts’ duty**

is to determine the legal nature of the transactions in question and then relate them to the fiscal legislation: see Lord Wilberforce, at p.326.

2 The *Ramsay* case brought out three points in particular. First, when it is sought to attach a tax consequence to a transaction, the task of the courts is to ascertain the legal nature of the transaction. **If that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded. Courts are entitled to look at a pre-arranged tax avoidance scheme as a whole. It matters not whether the parties' intention to proceed with a scheme through all its stages takes the form of a contractual obligation or is expressed only as an expectation without contractual force.**

3 This development had already been foreshadowed in the dissenting judgment of Eveleigh LJ in *Floor v Davis* [1978] Ch 295 and in decisions of the House in *Inland Revenue Comrs v Plummer* [1980] AC 896 and *Chinn v Hochstrasser* [1981] AC 533. In *Furniss v Dawson* [1984] AC 474, 526, Lord Brightman set out his understanding of the rationale of this approach in these terms:

“In a pre-planned tax-saving scheme, no distinction is to be drawn for fiscal purposes, because none exists in reality, between (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract, and (ii) a like series of steps which are followed through because the participants are contractually bound to take each step seriatim. In a contractual case the fiscal consequences will naturally fall to be assessed in the light of the contractually agreed results ... *Ramsay* says that the fiscal result is to be no different if the several steps are pre-ordained rather than pre-contracted.”

4 Second, this is not to treat a transaction, or any step in a transaction, as though it were a “sham”, meaning thereby, that it was intended to give the appearance of having a legal effect different from the actual legal effect intended by the parties: see the classic definition of Diplock LJ in *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786, 802. Nor is this to go behind a transaction for some supposed underlying substance. **What this does is to enable the court to look at a document or transaction in the context to which it properly belongs.**

5 Third, having identified the legal nature of the transaction, the courts must then relate this to the language of the statute. For instance, if the scheme has the apparently magical result of creating a loss without the taxpayer suffering any financial detriment, is this artificial loss a loss *-within the meaning of the relevant statutory provision?* Thus, in *Ramsay* the taxpayer company sought to create an allowable loss to offset against a chargeable gain it had made on a sale-leaseback transaction. It sought to do so without suffering any financial detriment, by embarking on and carrying through a scheme which created both a loss which was allowable for tax purposes and a matching gain which was not chargeable. In rejecting the efficacy of this contrived “loss-creating” scheme, Lord Wilberforce [1982] AC 300, 326, observed, that a loss which comes and goes as part of a pre-planned, single continuous operation “is not such a loss (or gain) as the legislation is dealing with”. In *Inland Revenue Comrs v Burma Oil Co Ltd* [1982] STC 30, 37 Lord Fraser of Tullybelton described this passage as the ratio of the decision in the *Ramsay* case.”

Lord Hoffmann:

p.326/7, paragraph 32

“32 My Lords, it is worth pausing at this point to examine the characteristically compressed reasoning in a little more detail. **A loss which arises at one stage of an indivisible process and cancelled out at a later stage of the same process is “not such a loss as the legislation is dealing with”.** The tax was not imposed “on arithmetical differences”. In that case, what kind of loss was the legislation dealing with? The contrast being made throughout Lord Wilberforce’s speech is between juristic or arithmetical realities on the one hand and commercial realities on the other. He is construing the words “disposal” and “loss” to refer to commercial concepts which are not necessarily confined by the categories of juristic analysis. In the *Ramsay* case [1982] AC 300, a director, or an accountant concerned to present a true and fair view of the taxpayer’s dealings, would not have said that the company had entered into a transaction giving rise to a loss which happened to have been offset by a corresponding gain. There had never been any commercial possibility that the transactions would not have cancelled each other out. Therefore, notwithstanding the juristic independence of each of the stages of the circular transaction, the commercial view would have been to lump them all together, as the parties themselves intended, and describe them as a composite transaction which had no financial consequences. The innovation in the *Ramsay* case was to give the statutory concepts of “disposal” and “loss” a commercial

meaning. The new principle of construction was a recognition that the statutory language was intended to refer to commercial concepts, so that **in the case of a concept such as a “disposal”, the court was required to take a view of the facts which transcended the juristic individuality of the various parts of a preplanned series of transactions.”**

^J *Ramsay* [1982] AC 300

Lord Wilberforce p.326 (first two complete paragraphs)

“I have a full respect for the principles which have been stated but I do not consider that they should exclude the approach for which the Crown contends. That does not introduce a new principle: it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation. While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still. Such immobility must result either in loss of tax, to the prejudice of other taxpayers, or to Parliamentary congestion or (most likely) to both. To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process. **In each case the facts must be established, and a legal analysis made:** legislation cannot be required or even be desirable to enable the courts to arrive at a conclusion which corresponds with the parties’ own intentions.

The capital gains tax was created to operate in the real world, not that of make-belief. As I said in *Aberdeen Construction Group Ltd v Inland Revenue Commissioners* [1978] AC 885, it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. **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, is in my opinion well and indeed essentially within the judicial function.”**

^K *Ramsay* [1982] AC 300

Lord Wilberforce: p.328 (eighth paragraph)

“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.”

p.332 (fifth complete paragraph)

“On these facts, it would be quite wrong, and a faulty analysis, to segregate, from what was an integrated and interdependent series of operations, one step, viz. the sale of the Gibraltar reversion on April 3, 1975, and to attach fiscal consequences to that step regardless of the other steps and operations with which it was integrated. The only conclusion, one which is alone consistent with the intentions of the parties, and with the documents regarded as interdependent, is to find that, apart from a sum not exceeding £370, there was neither gain nor loss and I so conclude.”

Lord Fraser: p.337 (middle of final paragraph)

“In these circumstances the court is entitled and bound to consider the scheme as a whole: see *Inland Revenue Commissioners v Plummer* [1980] AC 896, 908 and *Chinn v Hochstrasser* [1981] AC 533. **The essential feature of both schemes was that, when they were completely carried out, they did not result in any actual loss to the taxpayer. The apparently magic result of creating a tax loss that would not be a real loss was to be brought about by arranging that the scheme included a loss which was allowable for tax purposes and a matching gain which was not chargeable.** In *Ramsay* the loss arose on the disposal of the appellant's shares in Caithmead Ltd. In *Rawling* it arose on the disposal of the appellant's reversionary interest in the retained part of the Gibraltar settlement. But it is perfectly clear that neither of these disposals would have taken place except as part of the scheme, and, when they did take place, the taxpayer and all others concerned in the scheme knew and intended that they would be followed by other prearranged steps which cancelled out their effect.”

^L *Burmah Oil* [1982] STC 30

Lord Fraser:

p.36g to j

“Paragraph 4(3) provides that if a person gives ‘any consideration for his new holding or any part of it, that consideration shall ... be treated as having been given for the original shares’. The latter phrase is, in my opinion, only a shorthand reference back to Sch 6, para 4(1)(a) which deals with the value of the consideration given ‘... wholly and exclusively for the *acquisition of the asset*’. (Emphasis mine.) The same must be true of the former phrase, because only if the consideration ‘given for’ the new shares is treated as having been given “wholly and exclusively for the acquisition of the original shares can it be allowable as a deduction in the computation of capital gain under para 4(1) of Sch 6. But although I am, for that reason, unable to agree with the learned Lord President’s comment on the design underlying para 4(3), that does not detract in any way from my agreement with his conclusion about the effect of para 4(2).”

p.38h to j

“The second series of events began on 18 December 1972. On that date, Burmah paid £159,600,000 to Holdings and in return it received 700,000 new shares in Holdings. **Burmah say that the money was paid in consideration for the shares, and so it was up to that stage. But there were later stages to come before the scheme was complete.** Most of the money (£159,299,999) was immediately passed on by Holdings to MORH, and by MORH back to Burmah on the same day. On 19 December, Holdings took the first steps towards voluntary liquidation, and on 29 December its only asset, consisting of a cash balance of £296,728-50, was distributed to its members, that is, to Burmah either directly or through BOTL, and Holdings was wound-up. Burmah’s shares in Holdings were thus destroyed. **The result was that although Burmah apparently suffered the loss of almost the whole price that it had paid for the new shares, except for the cash balance returned on liquidation, it suffered no real loss because it got back all the money...**”

^M *Furniss v Dawson* [1984] AC 474

Peter Millett QC arguendo: p.509 (second complete paragraph)

“The Crown does not invite the House to ignore or disregard the first step as though it never happened or by treating it as a sham. It did happen, it was genuine and, on the finding of the commissioners, it passed full legal and beneficial ownership of the shares to Greenjacket. **Had it stood alone, it would unquestionably have been a disposal but for the exemption in paragraph 4(2) of Schedule 7 to the Act of 1965. On the findings of the commissioners, however, that first step is not the relevant transaction but only part of it. The relevant transaction is the composite transaction, consisting of two steps. It is to that transaction that the legislation is to be applied. That composite transaction constituted a disposal by the taxpayers of the shares in the operating companies to the ultimate purchaser in consideration of cash paid by the direction of the taxpayers to, and received beneficially by, Greenjacket.**”

p.510 (last complete paragraph)

“The Court of Appeal misrepresented the Crown’s argument in the present case. The Crown does *not* contend that the transfer to Greenjacket ought to be disregarded in the sense of treated as if it did not happen, **but contends that it should be disregarded in the sense that it is not the relevant disposal.** Likewise, the Crown does not contend that the taxpayers ought to be taxed *as if* they had transferred the shares directly in a single step to the ultimate purchaser, but contends that they ought to be taxed on the basis that they transferred them by two steps to the ultimate purchaser, **those two steps** being planned and implemented as the component elements of a single transaction, **together constituting the relevant disposal for the purposes of the capital gains tax.**”

Lord Fraser: p.513 (final paragraph of speech)

“The series of two transactions in the present case was planned as a single scheme, and I am clearly of opinion that it should be viewed as a whole. **The relevant transaction**, if I may borrow the expression used by Lord Wilberforce [1982] AC 300, 324, **consists of the two transactions or stages taken together. It**

was a disposal by the respondents of the shares in the operating company for cash to Wood Bastow.”

Lord Roskill: p.515 (final paragraph)

“In conclusion, therefore, I am convinced that there was a disposal by the Dawsons to Wood Bastow in consideration of the payment to be made by Wood Bastow to Greenjacket at the behest of the Dawsons. This disposal is not exempt. Capital gains tax is payable. It is for these reasons as well as for those expressed by my noble and learned friends to whose speeches I have already referred that I would allow these appeals. I would however make no order as to costs either in this House or in the courts below.”

Lord Brightman: p.527 (before the first paragraph)

“Under such a tripartite contract the Dawsons would clearly have disposed of the shares in the operating companies in favour of Wood Bastow in consideration of a sum of money paid by Wood Bastow with the concurrence of the Dawsons to Greenjacket. Tax would be assessed, and the base value of the Greenjacket shares calculated, accordingly. *Ramsay* says that this fiscal result cannot be avoided because the preordained series of steps are to be found in an informal arrangement instead of in a binding contract. The day is not saved for the taxpayer because the arrangement is unsigned or contains the words “this is not a binding contract”.”

p.526 (last paragraph onwards)

“My Lords, in my opinion the rationale of the new approach is this. In a pre-planned tax-saving scheme, no distinction is to be drawn for fiscal purposes, because none exists in reality, between (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract, and (ii) a like series of steps which are followed through because the participants are contractually bound to take each step *seriatim*. In a contractual case the fiscal consequences will naturally fall to be assessed in the light of the contractually agreed results. For example, equitable interests may pass when the contract for sale is signed. In many cases equity will regard that as done which is contracted to be done. *Ramsay* says that the fiscal result is to be no different if the several

steps are pre-ordained rather than pre-contracted. For example, in the instant case tax will, on the *Ramsay* principle, fall to be assessed on the basis that there was a tripartite contract between the Dawsons, Greenjacket and Wood Bastow under which the Dawsons contracted to transfer their shares in the operating companies to Greenjacket in return for an allotment of shares in Greenjacket, and under which Greenjacket simultaneously contracted to transfer the same shares to Wood Bastow for a sum in cash. Under such a tripartite contract the Dawsons would clearly have disposed of the shares in the operating companies in favour of Wood Bastow in consideration of a sum of money paid by Wood Bastow with the concurrence of the Dawsons to Greenjacket. Tax would be assessed, and the base value of the Greenjacket shares calculated, accordingly. *Ramsay* says that this fiscal result cannot be avoided because the preordained series of steps are to be found in an informal arrangement instead of in a binding contract. The day is not saved for the taxpayer because the arrangement is unsigned or contains the words "this is not a binding contract."

The formulation by Lord Diplock in *Inland Revenue Commissioners v. Burma Oil Co. Ltd.* [1982] S.T.C. 30, 33 expresses the limitations of the *Ramsay* principle. (First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end. The composite transaction does, in the instant case; it achieved a sale of the shares in the operating companies by the Dawsons to Wood Bastow. It did not in *Ramsay*. Secondly, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax—not "no business *effect*." If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied.

In the instant case the inserted step was the introduction of Green-jacket as a buyer from the Dawsons and as a seller to Wood Bastow. That inserted step had no business purpose apart from the deferment of tax, although it had a business effect. If the sale had taken place in 1964 before capital gains tax was introduced, there would have been no Greenjacket.

The formulation, therefore, involves two findings of fact, first, whether there was a preordained series of transactions, i.e. a

single composite transaction, secondly, whether that transaction contained steps which were inserted without any commercial or business purpose apart from a tax advantage.

Those are facts to be found by the commissioners. They may be primary facts or, more probably, inferences to be drawn from the primary facts. If they are inferences, they are nevertheless facts to be found by the commissioners. Such inferences of fact cannot be disturbed by the court save on *Edwards v. Bairstow* [1956] A.C. 14 principles.

In *Marriott v. Oxford and District Co-operative Society Ltd.* (No. 2) [1970] 1 Q.B. 186, Lord Denning M.R. said, at p. 192:

“the primary facts were not in dispute. The only question was what was the proper inference from them. That is a question of law with which this court can and should interfere.”

Similar observations occur in other reported cases. I agree with the proposition only if it means that an appellate court, whose jurisdiction is limited to questions of law, can and should interfere with an inference of fact drawn by the fact-finding tribunal which cannot be justified by the primary facts. I do not agree with it if it is intended to mean that, if the primary facts justify alternative inferences of fact, an appellate court can substitute its own preferred inference for the inference drawn by the fact-finding tribunal. I think this is clear from the tenor of the speeches in this House in *Edwards v. Bairstow*. The point does not seem to have been the subject matter of explicit pronouncement in any of the reported cases, at least your Lordships have been referred to none, and both propositions have from time to time emerged in judgments as a matter of assumption rather than decision. But for my part I have no doubt that the correct approach in this type of case, where inferences have to be drawn, is for the commissioners to determine (infer) from their findings of primary fact the further fact whether there was a single composite transaction in the sense in which I have used that expression, and whether that transaction contains steps which were inserted without any commercial or business purpose apart from a tax advantage; and for the appellate court to interfere with that inference of fact only in a case where it is insupportable on the basis of the primary facts found. Accordingly I respectfully disagree with Vinelott J. in the instant case where he expressed the opposite view [1982] STC 267, 287B.

The result of correctly applying the *Ramsay* principle to the facts

of this case is that there was a disposal by the Dawsons in favour of Wood Bastow in consideration of a sum of money paid with the concurrence of the Dawsons to Greenjacket. Capital gains tax is payable accordingly. I would therefore allow the appeals. I agree that there should be no order for costs in your Lordships' House."

Arrowtown

Lord Millett NPJ:

p.49, paragraph 122

"122. The question was: what was the relevant disposal? Were there two disposals, as the taxpayers claimed, the first being a disposal by way of share exchange within the express words of a statutory exemption? Or was there only one disposal for the purpose of the statutory exemption, being a disposal by way of sale, as the Crown claimed? The Crown did not invite the House to ignore or disregard the disposal to Greenjacket as if it never happened or to treat it as a sham. It did happen; it was genuine; and the Crown accepted that it transferred the full legal and beneficial ownership of the shares to Greenjacket by way of share exchange. The Crown's case was that the fiscal consequences of the share exchange were to be disregarded because it was not the relevant disposal but only part of it. The relevant disposal was the composite transaction, which consisted of two steps and constituted a disposal of shares by way of sale, with the result that it fell outside the exemption for disposals by way of share exchange. The House of Lords agreed."

^N *Furniss v Dawson* [1984] AC 474

Peter Millett QC arguendo: p.509 (second complete paragraph)

"The Crown does not invite the House to ignore or disregard the first step as though it never happened or by treating it as a sham. It did happen, it was genuine and, on the finding of the commissioners, it passed full legal and beneficial ownership of the shares to Greenjacket. **Had it stood alone, it would unquestionably have been a disposal but for the exemption in paragraph 4(2) of Schedule 7 to the Act of 1965. On the findings of the commissioners, however, that first step is not the relevant transaction but only part of it. The relevant transaction is the composite transaction, consisting of two steps. It is to that transaction that the legislation is to be**

applied. That composite transaction constituted a disposal by the taxpayers of the shares in the operating companies to the ultimate purchaser in consideration of cash paid by the direction of the taxpayers to, and received beneficially by, Greenjacket.”

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“The Court of Appeal misrepresented the Crown’s argument in the present case. The Crown does *not* contend that the transfer to Greenjacket ought to be disregarded in the sense of treated as if it did not happen, **but contends that it should be disregarded in the sense that it is not the relevant disposal.** Likewise, the Crown does not contend that the taxpayers ought to be taxed *as if* they had transferred the shares directly in a single step to the ultimate purchaser, but contends that they ought to be taxed on the basis that they transferred them by two steps to the ultimate purchaser, **those two steps** being planned and implemented as the component elements of a single transaction, **together constituting the relevant disposal for the purposes of the capital gains tax.”**

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“My Lords, in my opinion the rationale of the new approach is this. In a pre-planned tax-saving scheme, no distinction is to be drawn for fiscal purposes, because none exists in reality, between (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract, and (ii) a like series of steps which are followed through because the participants are contractually bound to take each step seriatim. In a contractual case the fiscal consequences will naturally fall to be assessed in the light of the contractually agreed results. For example, equitable interests may pass when the contract for sale is signed. In many cases equity will regard that as done which is contracted to be done. *Ramsay* says that the fiscal result is to be no different if the several steps are pre-ordained rather than pre-contracted. For example, in the instant case tax will, on the *Ramsay* principle, fall to be assessed on the basis that there was a tripartite contract between the Dawsons, Greenjacket and Wood Bastow under which the Dawsons contracted to transfer their shares in the operating companies to Greenjacket in return for an allotment of shares in Greenjacket, and under which Greenjacket simultaneously contracted to transfer the same shares to Wood Bastow for a sum in cash. Under such a tripartite contract the Dawsons would clearly have disposed of the shares in the operating companies in favour of Wood Bastow in consideration of a sum of money paid by Wood Bastow with the concurrence of the Dawsons to Greenjacket. Tax would be assessed, and the base value of the Greenjacket shares calculated,

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In the instant case the inserted step was the introduction of Green-jacket as a buyer from the Dawsons and as a seller to Wood Bastow. That inserted step had no business purpose apart from the deferment of tax, although it had a business effect. If the sale had taken place in 1964 before capital gains tax was introduced, there would have been no Greenjacket.

The formulation, therefore, involves two findings of fact, first, whether there was a preordained series of transactions, i.e. a single composite transaction, secondly, whether that transaction contained steps which were inserted without any commercial or business purpose apart from a tax advantage. Those are facts to be found by the commissioners. They may be primary facts or, more probably, inferences to be drawn from the primary facts. If they are inferences, they are nevertheless facts to be found by the commissioners. Such inferences of fact cannot be disturbed by the court save on *Edwards v. Bairstow* [1956] A.C. 14 principles.

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“the primary facts were not in dispute. The only

question was what was the proper inference from them. That is a question of law with which this court can and should interfere.”

Similar observations occur in other reported cases. I agree with the proposition only if it means that an appellate court, whose jurisdiction is limited to questions of law, can and should interfere with an inference of fact drawn by the fact-finding tribunal which cannot be justified by the primary facts. I do not agree with it if it is intended to mean that, if the primary facts justify alternative inferences of fact, an appellate court can substitute its own preferred inference for the inference drawn by the fact-finding tribunal. I think this is clear from the tenor of the speeches in this House in *Edwards v. Bairstow*. The point does not seem to have been the subject matter of explicit pronouncement in any of the reported cases, at least your Lordships have been referred to none, and both propositions have from time to time emerged in judgments as a matter of assumption rather than decision. But for my part I have no doubt that the correct approach in this type of case, where inferences have to be drawn, is for the commissioners to determine (infer) from their findings of primary fact the further fact whether there was a single composite transaction in the sense in which I have used that expression, and whether that transaction contains steps which were inserted without any commercial or business purpose apart from a tax advantage; and for the appellate court to interfere with that inference of fact only in a case where it is insupportable on the basis of the primary facts found. Accordingly I respectfully disagree with Vinelott J. in the instant case where he expressed the opposite view [1982] STC 267, 287B.

The result of correctly applying the *Ramsay* principle to the facts of this case is that there was a disposal by the Dawsons in favour of Wood Bastow in consideration of a sum of money paid with the concurrence of the Dawsons to Greenjacket. Capital gains tax is payable accordingly. I would therefore allow the appeals. I agree that there should be no order for costs in your Lordships' House.”

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“122. The question was: what was the relevant disposal? Were there two disposals, as the taxpayers claimed, the first being a

disposal by way of share exchange within the express words of a statutory exemption? Or was there only one disposal for the purpose of the statutory exemption, being a disposal by way of sale, as the Crown claimed? The Crown did not invite the House to ignore or disregard the disposal to Greenjacket as if it never happened or to treat it as a sham. It did happen; it was genuine; and the Crown accepted that it transferred the full legal and beneficial ownership of the shares to Greenjacket by way of share exchange. The Crown's case was that the fiscal consequences of the share exchange were to be disregarded because it was not the relevant disposal but only part of it. The relevant disposal was the composite transaction, which consisted of two steps and constituted a disposal of shares by way of sale, with the result that it fell outside the exemption for disposals by way of share exchange. The House of Lords agreed."

^P *Craven v. White* [1989] AC 398

Lord Oliver:

p.509 (final paragraph)

"My Lords, for my part I find myself unable to accept that *Furniss* either established or can properly be used to support a general proposition that any transaction which is effected for the purpose of avoiding tax on a contemplated subsequent transaction and is therefore "planned" is, for that reason, necessarily to be treated as one with that subsequent transaction and as having no independent effect even where that is realistically and logically impossible. **The particular question which fell to be determined in *Furniss* was, as it is in the present appeals, whether an intermediate transfer was, at the time when it was effected, so closely interconnected with the ultimate disposition that it was properly to be described as not, in itself, a real transaction at all but merely an element in some different and larger whole without independent effect. That is, I think, necessarily a question of fact but it has to be approached within the bounds of what is logically defensible.**"

^Q *Ensign Tankers* [1992] 1 AC 655

Lord Templeman: p.661 (third and fourth complete paragraphs)

"By section 41 of the Finance Act 1971 Parliament sought to

encourage a British trader to spend capital on machinery or plant for the purposes of his trade. The encouragement took the form of allowing the trader in the computation of his income tax or corporation tax to deduct the expenditure from his profits in the year of expenditure. Section 41(1) is in the following terms:

“where (a) a person carrying on a trade incurs capital expenditure on the provision of machinery or plant for the purposes of the trade, and (b) in consequence of his incurring the expenditure, the machinery or plant belongs to him at some time during the chargeable period related to the incurring of the expenditure, there shall be made to him for that period an allowance (in this chapter referred to as ‘a first year allowance’) which shall be of an amount determined in accordance with section 42 below ...”

In 1980 the master negative of a commercial film constituted plant for the purposes of this section and the first year allowance was 100 per cent.”

p.666 (end) and p.667 (passim)

“This statement is not wholly accurate. Victory Partnership did not put up 25 per cent of the cost but only \$3¼m. LPI, did not put up 75 per cent of the cost but the whole of the cost of \$14m in excess of \$3¼m. The associated company did not retain a 75 per cent participation. In the events which happened, the participation was that of LPI, which was entitled to receive and did receive 75 per cent of the net receipts amounting to \$9m. Allowing for these inaccuracies the judge was quite right in his analysis of the true legal effect of the transaction. The transaction was a joint venture and contained no element of loan. That analysis leads to two conclusions. **First, upon the true construction of the 17 documents dated 14 July 1980 read as a whole the only expenditure of Victory Partnership for the purposes of section 41 of the Act of 1971 or for any other purpose for that matter amounted to \$3¼m and no more. Secondly, the 17 documents do indeed incorporate a tax avoidance scheme, that is to say, a single composite transaction whereunder the tax advantage claim by the taxpayer, namely a first year allowance of \$14m, is inconsistent with the consequence of the transaction, in this case the expenditure of \$3¼m.** Unfortunately, the judge continued as follows:

“In legal terms, however, LPI, was not an equity participant, for it was making its contribution by way of loan. But a loan creditor would normally expect to be repaid before equity participants recovered any part of their capital, whereas LPI’s advance was recoverable only out of film receipts and was repayable *pari passu* with instead of ahead of Victory Partnership’s capital investment. In these circumstances, the retention of a 75 per cent participation in the profits by the loan creditor or its associated company is not difficult to justify.”

This analysis ignores the fact that by reason of the non-recourse provision of the loan agreement, the loan was not repayable by Victory Partnership or any one else. A creditor who receives a participation in profits *in addition* to repayment of his loan is of course a creditor. But a creditor who receives a participation in profits *instead of* repayment of his “loan” is not a creditor. The language of the document in the latter case does not accurately describe the true legal effect of the transaction, which is a capital investment by the “creditor” in return for a participation in profits.

In a later passage Millett J. said, at p.1230:

“The non-recourse nature of the borrowing and the use of the limited partnership (either of which would have been sufficient without the other) provided a desirable protection for participants but were not necessary to the securing of the tax advantages sought to be obtained.”

But the non-recourse nature of the borrowing ensured that LPI paid the whole cost of the film exceeding \$3¼m and conversely that Victory Partnership would not be liable for the cost of the film in excess of \$3¼m. By the operation of the scheme current account in accordance with the provisions of the scheme, the money of LPI, at all times under the control of L.P.I., was electronically transferred from Hollywood to the City of London and back again without serving any useful purpose and leaving no trace except entries on computer prints. The scheme is one of many; it reflects no credit on Guinness Mahon, the merchant bank which invented it, or on the appellant and the other industrial companies which purchased it for many hundreds of thousands of pounds. If successful, the scheme would have been operated at the expense of the British public and, whether

successful or unsuccessful, involved the exploitation of British capital allowances for the making of a foreign film.”

^R *Ensign Tankers* [1992] 1 AC 655

Lord Templeman: p.666 (end) and p.667 (passim)

“This statement is not wholly accurate. Victory Partnership did not put up 25 per cent of the cost but only \$3¼m. LPI, did not put up 75 per cent of the cost but the whole of the cost of \$14m in excess of \$3¼m. The associated company did not retain a 75 per cent participation. In the events which happened, the participation was that of LPI, which was entitled to receive and did receive 75 per cent of the net receipts amounting to \$9m. Allowing for these inaccuracies the judge was quite right in his analysis of the true legal effect of the transaction. The transaction was a joint venture and contained no element of loan. That analysis leads to two conclusions. **First, upon the true construction of the 17 documents dated 14 July 1980 read as a whole the only expenditure of Victory Partnership for the purposes of section 41 of the Act of 1971 or for any other purpose for that matter amounted to \$3¼m and no more. Secondly, the 17 documents do indeed incorporate a tax avoidance scheme, that is to say, a single composite transaction whereunder the tax advantage claim by the taxpayer, namely a first year allowance of \$14m, is inconsistent with the consequence of the transaction, in this case the expenditure of \$3¼m.** Unfortunately, the judge continued as follows:

“In legal terms, however, LPI, was not an equity participant, for it was making its contribution by way of loan. But a loan creditor would normally expect to be repaid before equity participants recovered any part of their capital, whereas LPI’s advance was recoverable only out of film receipts and was repayable *pari passu* with instead of ahead of Victory Partnership’s capital investment. In these circumstances, the retention of a 75 per cent participation in the profits by the loan creditor or its associated company is not difficult to justify.”

This analysis ignores the fact that by reason of the non-recourse provision of the loan agreement, the loan was not repayable by Victory Partnership or any one else. A creditor who receives a participation in profits *in addition* to repayment of

his loan is of course a creditor. But a creditor who receives a participation in profits *instead of* repayment of his “loan” is not a creditor. The language of the document in the latter case does not accurately describe the true legal effect of the transaction, which is a capital investment by the “creditor” in return for a participation in profits.

In a later passage Millett J. said, at p.1230:

“The non-recourse nature of the borrowing and the use of the limited partnership (either of which would have been sufficient without the other) provided a desirable protection for participants but were not necessary to the securing of the tax advantages sought to be obtained.”

But the non-recourse nature of the borrowing ensured that LPI paid the whole cost of the film exceeding \$3¼m and conversely that Victory Partnership would not be liable for the cost of the film in excess of \$3¼m. By the operation of the scheme current account in accordance with the provisions of the scheme, the money of LPI, at all times under the control of L.P.I., was electronically transferred from Hollywood to the City of London and back again without serving any useful purpose and leaving no trace except entries on computer prints. The scheme is one of many; it reflects no credit on Guinness Mahon, the merchant bank which invented it, or on the appellant and the other industrial companies which purchased it for many hundreds of thousands of pounds. If successful, the scheme would have been operated at the expense of the British public and, whether successful or unsuccessful, involved the exploitation of British capital allowances for the making of a foreign film.”

^S *McGuckian* [1997] 1 WLR 991

Lord Browne-Wilkinson:

p.995/996

“**The crucial question, therefore, is whether in the present case the moneys received by Shurltrust** as consideration for the assignment of the right to the dividends from Ballinamore **fall to be treated as “income” of Shurltrust**. Prima facie those moneys, being the price of the sale by Shurltrust of its right to the future dividends of Ballinamore, constitutes capital not income. However, the Crown argue that, applying the *Ramsay* principle [1982] AC 300, that sale of the right to the dividends by

Shurltrust to Mallardchoice, though not a sham, has to be disregarded for tax purposes. **The sale was an artificial transaction** inserted for the sole purpose of gaining a tax advantage: **the reality of the transaction was the payment of a dividend by Ballinamore to the shareholder, Shurltrust, which received it as income.**"

p.998 (penultimate paragraph of speech)

"Finally, Mr. Nugee submitted that the *Ramsay* principle [1982] A.C. 300 only requires the artificial steps inserted for tax purposes to be disregarded if, apart from the *Ramsay* principle, they would have been effective to achieve a tax advantage. My Lords, I emphatically reject this submission. The approach pioneered in the *Ramsay* case and subsequently developed in later decisions is an approach to construction, viz. that in construing tax legislation, the statutory provisions are to be applied to the substance of the transaction, disregarding artificial steps in the composite transaction or series of transactions inserted only for the purpose of seeking to obtain a tax advantage. The question is not what was the effect of the insertion of the artificial steps but what was its purpose. Having identified the artificial steps inserted with that purpose and disregarded them, then **what is left is to apply the statutory language of the taxing Act to the transaction carried through stripped of its artificial steps.** It is irrelevant to consider whether or not the disregarded artificial steps would have been effective to achieve the tax saving purpose for which they were designed."

^T *McGuckian* [1997] 1 WLR 991

Lord Steyn: p.1002 (second complete paragraph)

"On a formalistic view of the individual tax avoidance steps, and a literal interpretation of the statute in the spirit of the *Duke of Westminster* case [1936] AC 1, it is possible to say that the money which reached Shurltrust was capital. But the court is no longer compelled to look at transactions in blinkers, and literalism has given way to purposive interpretation. Like Lord Cooke of Thorndon, and for the reasons he has given, **I would even without the benefit of the detailed legal analysis in the *Ramsay* line of authority have inclined to the view that the more realistic interpretation of the undisputed facts is that what Shurltrust received was income.** But, if the *Ramsay* principle [1982] AC 300, is taken into account, as it must be,

there is no room for doubt. The limits of the principle were summarised by Lord Brightman in *Furniss v. Dawson* [1984] AC 474. In his leading speech Lord Brightman said, at p. 527:

“First, there must be a pre-ordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end ... Secondly, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax-not ‘no business *effect*’. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied”.

Lord Cooke:

p.1003/4

“My Lords, it seems to me that one has only to recount those facts to show that what was received by Shurltrust was essentially income. The dividend was intended to be for the benefit of Shurltrust and the circular route by which the payment was made was no more than machinery for giving effect to that intention. The assignment was created simply as a bridge or vehicle for attaining that end. The money was unmistakably traceable through a single link. Whether a receipt is income for tax purposes is a question of mixed fact and law. In this instance the facts, in my view, admit of only one reasonable answer.”

p.1007 (last paragraph)

“My Lords, this approach to the interpretation of taxing Acts does not depend on general anti-avoidance provisions such as are found in Australasia. Rather, it is antecedent to or collateral with them. In the *Furniss* case [1984] A.C. 474, 527 Lord Brightman spoke of certain limitations (a pre-ordained series of transactions including steps with no commercial or business purpose apart from the avoidance of a liability to tax). The present case does fall within these limitations, but it may be as well to add that, if the ultimate question is always the true bearing of a particular taxing provision on a particular set of facts, the limitations cannot be universals. Always one must go back to the discernible intent

of the taxing Act. I suspect that advisers of those bent on tax avoidance, which in the end tends to involve an attempt to cast on other taxpayers more than their fair share of sustaining the national tax base, do not always pay sufficient heed to the theme in the speeches in the *Furniss* case, especially those of Lord Scarman, Lord Roskill and Lord Bridge of Harwich, to the effect that the journey's end may not yet have been found. I will profit from the example of Lord Roskill in the *Furniss* case, at p.515, by refraining from speculating about whether a sharper focus on the concept of "wages" in the light of the statutory purpose and the circumstances of the case would or would not have led to a different result in the *Duke of Westminster* case [1936] AC 1."

^U *MacNiven* [2003] 1 AC 311

Lord Nicholls: p.320, paragraph 9

"9 On the present appeal the relevant question is whether the transactions between the taxpayer, Westmoreland Investments Ltd ("WIL"), and the sole shareholders of its parent company, the trustees of the Electricity Supply Pension Scheme, constituted payments of interest within the meaning of section 338 of the Income and Corporation Taxes Act 1988. WIL suffered badly in the commercial property slump of the 1970s. It borrowed heavily from the pension scheme trustees. By the late 1980s it owed the trustees over £70m, including more than £40m accrued interest. Its liabilities greatly exceeded its assets. All the liabilities were due to the pension scheme trustees."

Lord Hoffmann: p.322, paragraph 19

"19 The question in this appeal is whether certain payments of interest made by a property investment company named Westmoreland Investments Ltd ("WIL") in the years 1988 to 1990 were "charges upon income" within the meaning of section 338 of the Income and Corporation Taxes Act 1988 and therefore allowable deductions in computing its profits or losses for the purposes of corporation tax. I speak of them as payments in the sense that there *is* no dispute that WIL transferred money to the lender and that its liability for interest was thereby discharged. As between the parties, the interest was paid. But the dispute between the taxpayer and the Crown is whether the interest was "paid" within the meaning of section 338. It arises because WIL paid the interest out of money which it had been lent by the

lender for the specific purpose of enabling it to pay. The interest liability was replaced by a liability for an additional capital sum. The transaction was circular: WIL borrowed capital and paid it back as interest. And the only purpose of the transaction was to produce an allowable deduction for corporation tax. The Crown says that this does not count as a payment for the purposes of the Act. It must be disregarded under the principle in *W T Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300. The main issue in this appeal is therefore the meaning, scope and applicability of that principle. The Crown also says that the taxpayer's claim is defeated by three specific anti-avoidance provisions in the Taxes Act. I shall deal with these after considering the main point."

^v *MacNiven* [2003] 1 AC 311

Lord Nicholls:

p.321, paragraph 14

"14 Section 338(1) provides, in short, that charges on income shall be allowed as deductions against profits in computing the corporation tax of a company. "Charges on income" are defined in section 338(2) as "payments of any description mentioned in subsection (3) below". So far as relevant, subsection (3) provides that "the payments referred to in subsection (2)(a) above are - (a) any yearly interest..." Prima facie, payment of interest in section 338 has its normal legal meaning, and connotes simply satisfaction of the obligation to pay. **In the present case, WIL's obligation to pay the accrued interest to the trustees was discharged by satisfaction. Thus, if the Inland Revenue are to succeed, payment in section 338 must bear some other meaning. Ultimately, applying in full the purposive Ramsay approach to interpretation, I can find no justification for giving payment in section 338 some other meaning. Moreover, I am unable to see what that other meaning could be.**"

Lord Hoffmann:

p.337, paragraph 67

"67 My Lords, payment of a debt such as interest ordinarily means an act, such as the transfer of money, which discharges the debt. **It is accepted that in this case the interest debt was indeed discharged. So why did this not count as payment for the purposes of the Act? One of the difficulties which I have with the argument for the Crown is that I find the alternative concept of payment for which it contends completely elusive. It is easy to understand a commercial sense of a loss which**

treats as irrelevant the fact that one part of a composite transaction produced a loss which was never intended to be more than momentary and theoretical. But what is the commercial concept of payment of a debt which treats as irrelevant the fact that the debt has been discharged? Mr McCall does not contend that payment must involve a negative cash flow which is not compensated by a cash flow in the opposite direction. He accepts, for example, that many commercial refinancing operations discharge old debts and create new ones without any cash flow either way. Nor is there any apparent policy to be found in section 338 which would require a negative cash flow. Otherwise, why should bank interest be deductible without any payment at all? As I have already said, the only apparent reason for the insistence on payment of yearly interest is that payment gives rise to an obligation to deduct tax. In the present case, WIL complied with that obligation. The Crown's real complaint is that the scheme, as an exempt fund, was able to reclaim the tax. But this cannot be remedied by giving the word "paid" a different meaning in the case of a payment to an exempt lender. The word must mean the same, whatever the status of the lender."

p.339, paragraph 69

"Bingham LJ said, at p 921:

"If we were entitled to disregard the legal effect of what was done here and give effect to the underlying substance, it might be possible to say that these payments were not really payments because they were made for the purpose of avoiding VAT and without any (or any other) commercial justification. But that is an approach which Lord Tomlin's well-known speech in *Inland Revenue Comrs v Duke of Westminster* [1936] AC 1, 19-21, roundly condemned where the transaction in question is genuine and I do not understand the principle there laid down, described as 'cardinal' by Lord Wilberforce in *W T Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300, 323, to have been diluted or abrogated by later decisions. If the payments are to be disregarded the commissioners would, I think, have to show them to be a sham, and this they have not sought to do. If, as I have concluded, these were in law good contractual payments, then I do not think we are entitled to disregard their legal effect and treat them as

something else.”

In other words, Bingham LJ was saying that “payment” in section 5(1) was a legal concept and did not have some other commercial meaning. **In my opinion the same is true of “paid” in section 338 of the Taxes Act 1988.**”

Lord Hope:

p.341, paragraph 81

“81 On this approach the case does not seem to me, in the end, to give rise to any real difficulty. **The words “paid” and “payment” are to be construed according to their ordinary meaning. The question whether a payment has been made is a question of fact. That question has been answered by the findings made by the special commissioners. The evidence established to their satisfaction that a loan was in fact made by the scheme to WIL and that WIL used that loan to pay interest to the scheme. The interest was a charge on income because it was a payment of a description mentioned in section 338(3) of the 1988 Act. That point having been established, the rule in section 338(1) determines the fiscal effectiveness of the transaction for the purposes of WIL’s liability to corporation tax.**”

^W *Shiu Wing Steel* (HK CFA)

Sir Anthony Mason NPJ:

p.4

“The Estate Duty Commissioner does not challenge the genuineness of the transactions, as summarized above, and accepts that they did in fact take place. He says however that when other factors are put into the equation and the principles of construction developed in *W T Ramsay Ltd v IRC* [1982] AC 300 are applied, it can be seen that in reality what Mr Pong did on 25 January and 24 October 1990 was to have made immediate gifts of his Hong Kong shares and properties to his children by way of settlements upon trust: Since he died, unfortunately, on 23 January 1993, three days short of the 3 years provided for in s.6(1)(c), all the shares and properties became assessable to estate duty.”

p.11

“The central issue in this appeal is whether certain dispositions,

made in his lifetime by Pong Ten Un (“the deceased”) who died on 23 January 1993, are to be treated for estate duty purposes as transfers, made by way of gift, of property situate in Hong Kong. The dispositions, which were made in the course of a complex series of transactions were evidently made with the provisions of s.10 of the Estate Duty Ordinance, Cap. 111, (“the Ordinance”) in mind. The second provides:

“Estate duty shall not be payable in respect of -

...

(b) property situate outside Hong Kong.”

^x In *Arrowtown* (HK CFA) the question was the meaning of the words “issued share capital” in the Stamp Duty Ordinance. The analytical technique adopted involved viewing the issue of shares as part of a larger transaction and taking account of the reasons for the issue of the shares. It is difficult to see how the statutory language justifies the adoption of this technique.