THE APPROACH OF THE COURTS
TO TAX PLANNING SCHEMES

By David Goldberg QC

So far as my researches go, it appears that there were no significant concerns in our society about legal tax avoidance, as distinct from evasion, until 1906 when a Select Committee was appointed to consider certain income tax matters and, for the first time in our tax literature, used the phrase "legal avoidance".

Even then, however, there does not appear to have been a lot of concern about the phenomenon of legal avoidance until after the First World War. Indeed in the last pre-First World War budget debates Lloyd George had said

1. "it is perfectly true that you can make legal arrangements … to evade taxes. I am perfectly well aware of that … the moment it is done the Inland Revenue can submit a scheme which will stop all that kind of spiders web … I considered whether it should be stopped this time and the only

> reason why it was not done was because I was advised that at the present moment it was not worthwhile".

In large measure this was because rates of income taxation were at an acceptably low level: it was not really worth the bother of taking steps to avoid it. But the need to finance modern warfare led to higher rates of income tax and to things like the super tax now, more prosaically, called higher rate tax and this, in turn, led to the desire among taxpayers legally to avoid tax by whatever means were available to them: tax advisers sharpened their craft and became more and more skilled at plans intended to avoid taxes; and the legislature began to introduce provisions designed to limit the scope for avoidance.

And so the battle between unwilling but law-abiding taxpayer and the all powerful legislature began; and in this battle the Courts are the referee.

In the beginning the Courts did not really take sides: they acted like true referees and ensured that both sides played properly. So in what, I suppose, is still the best known tax avoidance case of all time, the <u>Duke of Westminster's</u> case (19 TC 490 at 520) Lord

Tomlin says in a famous phrase:

> 2. "every man is entitled to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be".

As is well known, the Duke had stopped paying non-deductible wages to his gardeners and had, instead, covenanted to make them payments of income which, if they were correctly characterised as annuities, would be deductible.

One of the arguments put to the House of Lords was that, in substance, the annuities were wages. The House of Lords rejected this claim: as Lord Tomlin says:

> 3. "Here the substance is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles"

and Lord Wright says:

> 4. "The true nature of the legal obligation and nothing else is the substance".

It is often said that this case established that, in the United Kingdom, form is paramount and substance is to be ignored: as we shall see, this case, properly understood, is not authority for that proposition at any rate when it is put that way; but it has never been over-ruled and it <u>is</u> authority for the proposition that a transaction cannot have substance which is different from its form: the point is important.

So the Courts began with at least neutrality, if not sympathy towards the taxpayer.

But tax planning became more advanced. UK residents began to move their assets offshore to, for example, Prince Edward Island, a Province of Canada, which seems to have gone in for creating business organisations specially designed to assist attempts at avoidance during the inter-war years.

One of those who transferred his assets abroad was Lord Howard de Walden: the question which arose was whether Lord Howard de Walden remained taxable on income which accrued to companies in which, indirectly, he had interests; the case arose under what is now ICTA 1988 s.739 and it came for hearing in the Court of Appeal in 1941, amidst the clash of arms, when it was held that Lord

Howard de Walden was still taxable on the income accruing to the Canadian companies.

On the facts of the case, that conclusion could have led to double taxation and this is what Lord Greene said about that possibility:-

> 5. "For years a battle of manoeuvre has been waged between the Legislature and those who are minded to throw the burden of taxation off their own shoulders on to those of their fellow subjects. In that battle the Legislature has often been worsted by the skill, determination and resourcefulness of its opponents, of whom the present Appellant has not been the least successful. It would not shock us in the least to find that the Legislature has determined to put an end to the struggle by imposing the severest of penalties. It scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers."

So we can see that, at least during time of war, Courts had abandoned a neutral approach and were rather more sympathetic to the authorities than to taxpayers.

But then peace broke out while tax rates remained high and Mr Macmillan, in a famous phrase, told electors

> "You never had it so good."

And that was true not only for electors generally but also for the tax avoidance industry because, by this time, dividend stripping had been "discovered" and companies existed which specialised in providing dividend stripping services to those who, if not exactly in need of them, wanted to use them.

In its simplest form dividend stripping is a bit like bed and breakfasting a share cum div. Shares in a company were sold pregnant with dividend to a share dealer who bought them for £x. He then took a dividend of £y (which did not come into the computation of his taxable profit) and sold the shares for £x - £y making a loss which he could set against his profits (which, for these purposes, did include the dividend) and so reclaim tax. Ignoring tax, his profit from the transaction was modest: the tax reclaim made the transaction profitable. What I have described was the so-called backward strip. It was tax avoidance naked and unashamed and, when it was first considered in the House of Lords in Griffiths v. Harrison 40 TC 281, it was held, interestingly reversing the Special Commissioners, to work.

However, backward strips were stopped by statute and the next development was the forward strip, This came to be considered in Lupton v. F.A. & A.B. Ltd 47 TC 618. In a forward strip the dividend stripper bought the shares and held them for a period while dividends were paid to him out of current profits: after that period he sold the shares and made the conventional loss.

It can be seen that the forward strip is not very different from the backward strip except, really, for the period for which the dividend stripper held the shares.

But this time the House of Lords were not prepared to say that these were trading transactions. It decided that the transactions were so dominated by their tax avoidance purposes that they could not be described as trading.

Lord Morris said this:

6. “As a result of the above-noted feature of revenue

> law and of various other features there have emerged in recent periods certain hybrid transactions. These are paraded by their admirers as possessing the guise and the garb of trading transactions. Others think of the analogy of a wolf in sheep's clothing with the Revenue as the prey. It may be that there are some who have become specialists in the devising of such transactions and who as a result are sought out by and are consulted by vendors of shares who seek to have part of the profit for which such transactions provide. If any of these specialists are to be found amongst those whose ordinary trade is that of dealing in shares it must be said that in the fashioning of these tax engineering operations they may be stepping aside from the paths of their trade. The question in any particular case may be whether they have so stepped aside."

It is worth pausing here to make two points.

First, I have surveyed in what I have said so far the period from 1799, when Pitt introduced the first income tax in this country, to

1971, when Lupton v. F.A. & A.B. Ltd was decided, and I have mentioned only four cases about tax avoidance.

Now it is, of course, true that I could have mentioned other cases which were about tax avoidance. But while some of them (like Johnson v. Jewitt 40 TC 231) deal with general principles, most of those that I have not mentioned which could be said to be concerned with tax avoidance were about the limited question of whether a particular transaction was caught by a particular statutory provision: they do not really evidence anything that might be called an approach by the Courts to tax avoidance.

If we are looking for something that might be called an approach to tax planning by the Courts I think the four cases to which I have referred are the only ones - they are certainly the chief ones - in which the question of tax avoidance is considered as a matter of general principle.

Secondly, in dealing with these cases, the Courts, no matter what general comments the judges may have been making about their attitude to tax avoidance, were undoubtedly doing something which fell within the judicial function and which nobody would have suggested came anywhere near the legislative function: the Courts were interpreting statutes and answering the question: "does this transaction fall within this section?"; or they were characterising a transaction as, for example, trading or not trading, in order to see, again, whether it fell within particular statutory wording.

So up until 1971 the Courts were performing a fairly limited function: they expressed neutral sentiments or disapproving sentiments but, essentially, they were performing a judicial task.

I do not think it can be said that 1971 (when Lupton was decided) marked a watershed, but the cases which came after Lupton are different, because they demonstrate a significantly broader approach by judges to their role in considering tax avoidance.

It appears that, until dividend stripping became popular, there was not anything like an organised tax avoidance industry in this country. But dividend stripping, coupled with the introduction of capital gains tax, seems to have brought into being organisations which made their living by selling tax avoidance schemes and it is quite striking that, while some of these schemes were aimed at reducing tax on income, many of them, perhaps the most elaborate, were aimed at reducing the more modest tax on capital gains.

At any rate, one way or the other, tax avoidance which, I think, used to be a bespoke thing specially tailored to the client by his ordinary adviser, was suddenly available off-the-peg and mass marketed, and more people did it than ever before. Every year, about Christmas time, the promoters of this type of thing revealed their new schemes and people could, as it were, go into their favourite tax avoidance shop and buy the scheme off the shelf, like soap powder from a supermarket.

And to begin with it all worked: the revenue accepted the schemes and tax was saved and, I suppose, the Exchequer suffered or, at any rate, was perceived to suffer.

But this golden age for tax planners did not last very long.

When you bought one of these schemes, you used to get what I might call a guarantee of free litigation (that is, that the promoter of the scheme would take one test case about it to the House of Lords). Purchasers thought that this was a guarantee that litigation, if it occurred, would be free to them. But the revenue started to attack these schemes and it very soon became apparent that the guarantee was that there would be litigation: whether it was free or not soon became of less relevance.

Compared with the cases we had from 1799 to 1971, a cataract of cases about tax avoidance has poured forth upon us since 1971.

I will not go into detail about these cases one by one. There are at least 14 of them beginning with Black Nominees and ending, so far with McGuckian but I will list those which are most important:

Black Nominees [1975] STC 372

Floor v. Davies [1978] STC 436

IRC v. Plummer [1979] STC 793

Chinn v. Collins [1981] STC 1

IRC v.Burmah Oil [1982] STC 30

Furniss v. Dawson [1984] STC 153

Commissioner of Inland Revenue v. Challenge Corporation [1987] AC 155

Craven v. White [1988] STC 476

Ensign Tankers v. Stokes [1992] STC 226

Moodie v. IRC [1993] STC 188

Fitzwilliam v. IRC [1993] STC 504

Pigott & Staines [1995] STC 114

Spectros Holdings v. IRC [1997] STC 114

- and now, very recently, IRC. v. McGuckian.

In some of these cases the taxpayer won and in others (in fact, in the majority) he lost. Sometimes the decision appears acceptable and justifiable, other times it seems to be uncomfortably broad.

I shall try to describe later the principles (if they can be dignified by that name) which emerge from these cases and see if we can find anything that might be called "an approach" by the Courts to tax avoidance.

But first I think it worth asking whether there is any pattern distinct from legal principles that can be discerned here.

All of the cases to which I have just referred either went, or could have been taken, to the House of Lords and it is, I think, generally accepted that every case or virtually every case which goes to the House of Lords could be decided either way. At any rate Lord Reid is reported by Alan Patterson in his book "The Law Lords" as saying that at least 90% of the cases which came before him could have been decided either way.

I do not suppose that the tax cases to which I have referred are any different: they were decided one way, but they could have been equally well decided the other way.

It is not altogether comfortable to think of law as this uncertain and, of course, there are limits to the uncertainty. But it exists and we ought to recognise that it exists.

Looking at all of the cases to which I have referred so far I suppose that, overall, we can say that, whatever the position was originally, there is now general judicial distaste for tax avoidance.

If cases were decided by taste alone we would have to expect that taxpayers would always lose. But we know that they sometimes win. If the law itself is an uncertain guide as to why this happens can we see some other pattern?

Some commentators have suggested that the cycle of taxpayers winning and losing depends on economic conditions in the country generally: if the country is in trouble taxpayers lose; if it is doing well, they win.

I think this correlation may actually have existed whether by coincedence or not, up until 1971; but I do not think we can find the correlation since then. The country was not doing all that well in 1993 when <u>Fitzwilliam</u> was decided, or in 1979, when <u>Plummer</u> was decided.

Then another suggestion is that judges are altogether more tender towards inherited wealth than earned money. I think there may be something in this suggestion: at any rate it helps to explain the swing between Fitzwilliam and McGuckian. I might add that, if this is true, it is deplorable: economists have known for years that a country needs to produce wealth if it is to remain prosperous and to grow; and the protection of inherited wealth rather than earned money would be bad economics even if it were not bad law.

Another correlation that might be found is between originality and success and development and failure.

If we see tax avoidance schemes as going in cycles, it does seem that the first of each cycle is successful (Westminster, Plummer, Fitzwilliam) while developments from them fail. Again it may be noted that McGuckian follows Fitzwilliam.

I think this may be because judges in the House of Lords are initially attracted by the sheer cleverness of many tax plans and then later repulsed by the extent to which they are used.

In the end, however, it has to be accepted that none of these patterns is going to provide a very clear guide to what is happening.

So if we cannot look to patterns to divine the outcome of a case, can what the judges themselves have said in the cases be a good guide and, if so, what is it that they have said?

Have they said "if we (the judges) do not like the sort of thing that you have done it will not work" or have they said "there are rules about this sort of thing and if you break them your plan will fail but if you do not it will work?"

The answer is that some judges have taken one of these views and some have taken the other.

When I began writing this talk, the better view of the authorities was that there are rules: the result of tax planning is not supposed to be a matter of taste or distaste; but there were some judges who were anxious to extend the rules or perhaps, to abandon rules altogether in favour of a test which depends entirely on taste. As I concluded my preparation, McGuckian was decided - and that seems to make the taste test the present flavour. It may have changed the balance of the authorities.

I shall try in a moment to say what the present "rules" about tax planning are and I shall also try to set them in their current context.

But, before doing that, it may be useful to make a short survey of the cases to see how we have got where we are.

In a more detailed study, we would begin with Black Nominees or Floor v. Davis but for our purposes today we can begin with Ramsay.

In Ramsay a taxpayer borrowed money from a financier and purchased two loans: he was supposed to make a tax free gain on one loan and an allowable capital loss on the other. In order to achieve this result, money was sent around in a circle or a series or circles, beginning and ending up with the promoter of the scheme.

Lord Wilberforce described the transactions this way:

> 7. "In each case two assets appear, like "particles" in a gas chamber with opposite charges, one of which is used to create the loss, the other of which gives rise to an equivalent gain which prevents the taxpayer from supporting any real loss, and which gain is intended not to be taxable. Like the particles, these assets have a very short life. Having served their purpose they cancel each other

> out and disappear. At the end of the series of operations, the taxpayer's financial position is precisely as it was at the beginning, except that he has paid a fee, and certain expenses, to the promoter of the scheme."

Not surprisingly, in the light of that description, the House of Lords decided that the taxpayer did not make any real loss and could not have tax relief for a loss.

Now, at the time, the case aroused some concern among tax planners and tax advisers. It seemed to involve a radical departure from the Duke of Westminster's case. But in fact Lord Wilberforce expressly said that it did not involve a departure from that case.

> 8. "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] AC 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."

And indeed with the benefit of quite a lot of time to think about Ramsay, it can be seen that, viewed on its own, it was quite a narrow decision that circular self cancelling transactions can be viewed as a whole, even when taking account of their form as distinct from their substance, and the tax consequences follow the commercial result which they are intended to achieve: if, commercially, the transactions achieve nothing, they achieve nothing so far as tax is concerned.

Next came <u>Burmah Oil</u> (54 TC 200). On one level, this case can be regarded as an application of the <u>Ramsay</u> doctrine that circular self cancelling transactions have no effect for tax purposes.

But the case is significant for remarks made by Lord Diplock and endorsed by Lord Scarman.

Lord Diplock said (see 54 TC 214 D to E):

9. "It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax-avoidance schemes to assume, that <u>Ramsay's</u> case did not mark a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable. The difference is in approach."

<u>Furniss v. Dawson</u> [1984] AC 474 was the next case in the

sequence. It is remarkable for three reasons. First, following the remarks of Lord Diplock in Burmah, it extended the Ramsay doctrine from circular self cancelling transactions to linear transactions. Secondly, it contained an extraordinary invitation, extended by Lord Scarman to his fellow judges to embark on a course of judicial law making. Lord Scarman said this (at [1984] AC at 513):

> 10. "I am aware, and the legal profession (and others) must understand that the law in this area is in an early stage of development. Speeches in your Lordship's House and judgments in the appellate courts of the United Kingdom are concerned more to chart a way forward between principles accepted and not to be rejected than to attempt anything so ambitious as to determine finally the limit beyond which the safe channel of acceptable tax avoidance shelves into the dangerous shallows of unacceptable tax evasion.
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> The law will develop from case to case. … What has been established with certainty by the House in Ramsay's case is that the determination of what

> does, and what does not, constitute unacceptable tax evasion is a subject suited to development by judicial process. The best chart that we have for the way forward … [is] Lord Diplock, in Inland Revenue Commissioners v. Burmah Oil Co Ltd … These words leave space in the law for the principle … that every man is entitled if he can to order his affairs so as to diminish the burden of tax. The limits within which this principle is to operate remain to be probed and determined judicially. Difficult though the task may be for judges, it is one which is beyond the power of the blunt instrument of legislation. Whatever a statute may provide, it has to be interpreted and applied by the courts: and ultimately it will prove to be in this area of judge-made law that our elusive journey's end will be found."

This was strong stuff. As we shall see, from Furniss to McGuckian, Courts subsequently refused this invitation, which was seen by many as going beyond the proper limits of the judicial function. But in McGuckian some of the judges in the House of Lords have expressly referred to it and said that it should be followed.

Thirdly, despite the width of Lord Scarman's remarks, Lord Brightman's speech in Furniss v. Dawson marked the beginning of a process which, as we shall see, established - or seemed to establish - that the principles derived from this line of cases are not as wide as Lord Scarman was suggesting they might be but are, rather, rule based.

So Lord Brightman says ([1984] AC at 527D):

11. "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."

The crucial point to note about this statement of the principles is that, no matter how the Court analyses the facts, it must still apply the taxing statute, according to its words, to the end result of the transactions.

Lord Oliver picked up on this passage in Lord Brightman's speech in his own opinion in Craven v. White [1989] AC 398 at 514 where he said:

> 12. "As the law currently stands, the essentials emerging from Furniss v. Dawson appear to me to be four in number: (1) that the series of transactions was, at the time when the intermediate transaction was entered into, pre-ordained in order to produce a given result; (2) that the transaction had no other purposes than tax mitigation; (3) that there was at that time no practical likelihood that the pre-planned events would not take place in the order

> ordained, so that the intermediate transaction was not even contemplated practically as having an independent life, and (4) that the pre-ordained events did in fact take place. 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."

And here then we have clear rules as to when the Court will refuse to apply a step by step analysis and will apply the taxing statute to the end result of a transaction.

However, it is just as Lord Oliver is setting out the rules applicable to the new principle that Lord Templeman enters the lists, sitting for the first time as a member of the House of Lords.

The principle which he advocates - clearly rejected by the majority in Craven v. White - is that "an artificial tax avoidance scheme does not alter the incidence of tax" - see [1989] AC at 484B.

But, if we pause here, it is apparent that the broad approach, which the Courts were invited to adopt by Lord Diplock and Lord

Scarman in Burmah and Furniss, was clearly rejected in Craven v. White.

Next comes Ensign Tankers (Leasing) Ltd v. Stokes.

This is a difficult case.

It purports to be an application of the Ramsay doctrine that circular self cancelling transactions can be ignored.

The difficulty with the case is that, in many senses, the transactions in Ensign Tankers were not self cancelling: the taxpayers in that case, having borrowed money, ended up with an interest in a partnership which had assets. A case could certainly be made that, on those facts, the end result to which the taxing Acts should have been applied was that the taxpayers had expended money to acquire assets.

In order to avoid this conclusion the House of Lords fastened on a feature which was that, to finance their investment, the taxpayers had borrowed money on non-recourse terms; and the House of Lords decided that the absence of recourse meant that there was no true expenditure incurred.

Accordingly, while the Court presented the case as an application of the principle that circular self cancelling transactions did not work there was, in fact, an element of re-characterisation going on here: expenditure funded by a non-recourse loan was held not to be expenditure at all. It is, moreover, questionable whether the decision reflects anything that could be called the commercial reality of the matter. I think most business people would have said that there was, in the so called real world, expenditure incurred by the taxpayers, even though there may have been no cost to them of incurring the expenditure. If Uncle Joe gives me money to buy an ice-cream, I incur the expenditure of buying it even though the cost is refunded to me.

So Ensign seems to go further than Ramsay or Furniss, as explained in Craven v. White, permitted and it is, perhaps, notable that Lord Oliver was not among the panel deciding this case.

Moreover the case seems to breach the principle that the Duke of Westminter's case has not been overruled and that the legal form determines the substance.

In some respects, then, Ensign Tankers could be taken as authority for the proposition that the Furniss doctrine does permit re-characterisation of transactions.

However, this seems not to accord with the decision in Craven v. White or, indeed, any decision before Ensign Tankers itself and the true analysis is probably that the House of Lords in Ensign Tankers were not following the majority in Craven v. White but, rather, Lord Templeman's principle that artificial tax avoidance schemes do not work.

Even so there are some remarks from which those concerned with tax planning can take comfort.

In his judicial pronouncements Lord Templeman has been concerned to draw a distinction between acceptable tax mitigation and unacceptable tax avoidance (see CIR v. Challenge Corporation [1987] AC 155 at 167 to 168).

It is difficult to know what Lord Templeman regards as unacceptable tax avoidance and what as acceptable tax mitigation, nor is it easy to see what criteria he applies in deciding whether a transaction is one or the other: there are references in those pronouncements to magic and things which are too good to be true and, where those features are present, a transaction will be unacceptable tax avoidance.

But we also know from his speeches that bed and breakfast transactions are to be regarded as real (see Furniss v. Dawson [1992] AC 676C to D and Craven v. White [1989] AC 493B to C).

And we also know that it is acceptable to strip a dividend before selling shares in a company - see Craven v. White [1989] AC 493C.

So if we pause here and try to analyse the position after Ensign Tankers it appears that the doctrine created by the Courts applies only to circular transactions and to transactions where the tax acts ask the question "to whom has this disposal been made?" (the latter class of case sometimes being referred to as involving linear transactions).

The doctrine does not apply to back to back transactions; and it does not apply to what I will call T-shaped transactions (for example a dividend strip followed by a share sale).

On this analysis, the extension to Craven v. White created by Ensign Tankers was only that circular transactions may be regarded as self cancelling where, on one analysis at least, the taxpayer has acquired an asset as a result of what he has done. But this is only where there are special features such as non-recourse loans.

Another possible view of Ensign is that it is purporting to apply the law to a real (that is substantive) analysis of the facts. The loans to the taxpayers were non recourse so, in the real world, they did not incur expenditure. As I have said that analysis is factually suspect but it may be what the House of Lords was doing.

On either of these views Ensign Tankers is not authority for the proposition that artificial tax avoidance does not work, even though it may be that Lord Templeman and Lord Goff, who gave the chief speeches in the case, were hoping that it might be so.

However, any hopes they might have had on that score were dashed - at least temporarily - by the decision in Fitzwilliam [1993] 1 WLR 1189.

Three principles emerged from the decision of the majority in that case.

First, a transaction cannot be disregarded for fiscal purposes simply because it was entered into for the purposes of avoiding tax on some later transaction - see p.1200.

Secondly, it is not possible to ignore steps in a pre-ordained scheme and treat them as a single indivisible whole unless it is intellectually possible so to treat them - see p.1202C.

Thirdly, it is not legitimate to alter the character of a particular transaction in a series or to pick bits out of it and reject other bits.

Lord Templeman delivered a vehement dissenting speech.

But despite the efforts of Lord Templeman and Lord Goff, by the time Fitzwilliam had been decided, the doctrine which emerged was really quite a narrow one and, it might be added, that it would appear that even Lord Templeman was not arguing for that broad an approach.

The doctrine - at least as I understood it after Fitzwilliam - said that circular transactions are to be ignored if they are self cancelling. There was scope for doubt about what was and what was not self cancelling but, after Fitzwilliam, a transaction should not be regarded as self cancelling unless it could be logically and intellectually construed as having no lasting effect.

The doctrine also applied to determine the answer, in the context of a linear series of transactions, to the question "between whom do the relevant transactions take place for tax purposes?"

But the doctrine did not go further than that: it did not apply to back to back transactions; it did not apply to bed and breakfast transactions; and it did not apply to dividend strips.

The doctrine - at least before McGuckian - was not a doctrine of substance over form: it was not a doctrine (as was affirmed by Pigott v. Staines [1995] STC 114) which permitted the re-characterisation of transactions: in law a lease cannot, for example, be regarded as a loan. The Courts could not say that the real end result of the series of transactions was different from the formal end result - and this seemed to be so even if Ensign was authority for a broad doctrine of adopting a so called real fact analysis.

And so, as the law stood before McGuckian, even if there were transactions in a pre-ordained series, it may not have mattered: the law had to be applied to the pre-ordained series and it perhaps applied in the same way, regardless of whether there had or had not been a pre-ordained series of transactions.

Now, however, we have McGuckian.

I have three comments about that case.

First, it is remarkable that there is no significant mention, in any of the speeches delivered in the case, of Lord Oliver's leading judgment in Craven v. White or of the judgment in Fitzwilliam.

If I am right that those cases imposed significant limitations on Ramsay and on Furniss, the absence of references to those judgments has implications for the doctrine of precedent: it is alarming to practitioners to find that considered judgments do not need to be referred to.

Secondly, Lord Browne-Wilkinson at least, presents McGuckian as a straightforward application of Lord Brightman's speech in Furniss.

This must be a doubtful analysis.

Lord Brightman insisted in Furniss that a taxpayer was to be taxed on the end result of his series of transactions.

What happened in McGuckian was that Shurltrust, the person by reference to whose income the McGuckian's were to be taxed under ICTA 1988 s.739, sold the right to a dividend for cash.

The end result of the transaction was that Shurltrust received capital for selling the right to receive a dividend and, applying Lord Brightman's approach, the McGuckians should have been taxed on that end result.

They have not been. Lord Browne-Wilkinson has said that the sale of the dividend can be ignored and, accordingly, the receipt of the sale proceeds for the dividend must be characterised as the receipt of the dividend itself.

This does not seem to me to be to tax the actual end result but, rather, to recharacterise the end result as a dividend rather than sale proceeds. While there is some intellectual attraction in ignoring the sale of the right to the dividend, that can only be done if the form of the transaction, which led to Shurltrust getting sale proceeds and not dividends is wholly ignored. To do that seems to me to be contrary to Craven v. White and to Fitzwilliam: it is to do what those cases and Piggott v. Staines have said should not be done, which is to prefer substance to form, though it is, perhaps, to do the same as may have been done in Ensign and apply what may be called a real fact analysis - the McGuckians got the same money as they would have got if they had got the dividend: in reality they got the dividend.

A remarkable feature of all the speeches in McGuckian is that they all maintain that all they are doing is applying a rule of statutory construction. But it is hard to see how this analysis is consistent with an approach which, as a matter of factual analysis, allows the receipt of sale proceeds to be treated as the same as the thing that is sold.

Thirdly, it is not clear where the law stands at the moment. Lord Steyn's speech in McGuckian allows a broad purposive approach to the interpretation of tax statutes with the undoubted preference of substance to form: Lord Cooke refers to Lord Scarman's speech in Furniss about map making as the touch stone.

These are difficult concepts. Legislation seldom tells us what its purpose is. FA 1997 Sch 12 is a rare exception. I am not clear that judges are well placed to determine the true purpose (which may include remote economic purposes) of tax legislation. It is not always - as judges seem to think - that there should be tax. What, for example, tells me that the purpose of the CGT legislation is to allow pre sale dividend strips. And a world in which form may be ignored is, in truth, Alice in Wonderland. If you are not bound by the form of a transaction, how do you determine what its substance is, other than by an uncontrolled exercise of free will? A rigorous logical analysis would, I am sure, conclude that no legally documented transaction can have a substance different from its form.

I am sure that no member of the House of Lords would accept this, but it seems to me that, by elevating substance (by which I mean here perceived economic substance) above form, McGuckian is a decision which says that tax planning will only work if it is acceptable to the judges and so is to be characterised as acceptable tax mitigation rather than unacceptable tax avoidance. This is not taxation by law, but taxation according to the length of the judge's foot.

It is, morover, difficult to know when tax mitigation shades into tax avoidance.

Perhaps one clue is that, ignoring its supposed tax effects, tax avoidance has no economic impact on the participants in the plan except that they pay a fee to an arranger: at any rate McGuckian was certainly a case of that type.

It is, indeed, worth noting that most of the cases which I have been discussing - certainly most of those which the taxpayer has lost - are concerned with marketed tax avoidance schemes which had no commercial purpose apart from the manufacture of a tax relief or the avoidance of tax. It is true that not all the cases which the taxpayer has lost are of that character.

But, even so, these cases are really telling us very little, as a matter of principle, about the tax analysis where a person chooses the most tax efficient of a number of ways of carrying out an ordinary commercial transaction: these cases - and I think this is still so despite McGuckian - do not tell us anything which need prevent us from stripping a dividend before selling a company or arranging back to back financing to avoid distributions or about leasing assets rather than buying them so as to enable more effective use to be made of capital allowances.

Indeed the cases may be regarded only as a warning against last minute tax planning where it is intended to carry out a commercial transaction and a warning against buying tax avoidance schemes which have no purpose but the manufacture of a tax relief or some other tax advantage.

Viewed in this way these cases are of limited importance to most of us in our every day dealings with tax: they deal, in a sense, with artificially manufactured situations rather than the commercial dealings with which most of us are concerned; and it is worth noting in this connection that, every year, there are a huge number of tax cases, very few of which are concerned with the question of tax avoidance.

It is also worth noting that most of the cases which broaden the Court's role in stopping tax avoidance are followed by another case which narrows the role. On that basis McGuckian should be followed by a judicial reaction against it.

Why then have these cases had such a large impact on our tax culture?

I think the answer is this. When tax was first introduced it was regarded by the judges as a wholly artificial construct, a burden which was not to be laid upon a person without clear words. As Mr Justice Rowlatt said in Cape Brandy Syndicate v. IRC 12 TC 358 at 366:

13. "In a taxing Act one has to look merely at what is

> clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the legislation used."

And see Grainger v. Gough 3 TC 318.

I do not think that represents the attitude of judges today.

I believe that the presumption, perhaps of everybody including the politicians, is that tax has become part of the law of nature. Perhaps it is no longer right to say that man is born free: man is born to be taxed but occasionally has liberties.

And because the presumption nowadays seems to be that there should be tax, judges are alert to look for excuses to find that tax is payable, the present favourite excuse being to find an alleged purpose behind the statutory words, though it may be that judges are not themselves best qualified to determine the purpose of tax legislation.

In part this has come about just because times have changed:

the rights of individuals have been subsumed in the notion that there is an inevitable minimum share to be taken by the organisation which we call the state.

But I think in part it has come about because of the distaste which judges have felt at manufactured tax avoidance schemes which had no commercial purpose but the manufacture of a tax benefit.

And this has led to an attitude on the part of many judges which applies whenever a taxpayer is claiming that he has carried out a transaction which has reduced the burden of tax.

Accordingly, although the cases about tax avoidance which I have been discussing are seldom of direct application to what I might call commercial tax planning, they have created a culture in which the Courts tend to view tax mitigation with suspicion in the context of a background belief that taxes are not supposed to be mitigated.

There is nothing in the authorities, read properly, to provide support or encouragement for this sort of attitude and it does not mean that tax planning schemes inevitably fail. But I do think it represents what might be called the approach of the Courts to tax planning schemes.

I might add that, if I am correct in my analysis of why judges approach tax cases in the way they do now, all of us who work closely with the tax system have a responsibility to see that we do not abuse it. We may have different perceptions from judges as to the true purpose of tax legislation and there may be borderline cases where it is not entirely clear whether that what is proposed is or is not abusive. But we all know that Fitzwilliam led to a revival of pure manufactured tax avoidance arrangements on a large scale. McGuckian is the price - paid a little earlier than might have been expected. It will be better for the users of, and workers in, the tax system if we do not consciously set out to abuse it.