"TAX AVOIDANCE": *CHALLENGE CORPORATION* AND *ENSIGN TANKERS* AFTER *WILLOUGHBY*

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1 The House of Lords Decision in *IRC v Willoughby*[2]

In another landmark decision, the House of Lords on 11th July 1997 unanimously rejected the Revenue's appeal against the quashing of assessments on Professor and Mrs Willoughby under what is now Taxes Act 1988, section 739 (Tax Avoidance - Transfer of Assets Abroad). Professor Willoughby had taken out single premium insurance policies with offshore insurers, one while he was resident and ordinarily resident in Hong Kong and the others after he had retired to the United Kingdom. The policies were of the "personal portfolio" type under which benefits payable were linked to a fund which was managed in consultation with the policyholder's investment advisers and with which no policies belonging to any other policyholder were linked. The insurance element in such policies is usually tiny. They are in substance indistinguishable from personal investment, except that as income and gains of the linked fund belong to the offshore insurer they are not, section 739 apart, directly taxable as those of the policyholder. Instead, there is, broadly speaking, a charge to income tax under the Chargeable Event provisions, now contained in Taxes Act 1988 Part XIII Chapter II, on any gain the policyholder realises from the policy. The Revenue assessed Professor Willoughby under section 739 to income tax on the income arising within the linked fund.

2 Importance of the Decision

2.1 The Interpretation of Taxes Act 1988 Section 739

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2 [1997] STC 995.

The decision is important for three reasons. Firstly, it establishes that a person can be caught by section 739 only if at the time of the offending transfer the transferor was ordinarily resident in the United Kingdom. This has been reversed by Finance Act 1997 section 81 as respects income arising after 25th November 1996.

2.2 The meaning of "Tax Avoidance"

Secondly, their Lordships, who all concurred in one judgment given by Lord Nolan, gave a restricted meaning to the phrase "avoiding liability to taxation", which could be enormously beneficial to taxpayers challenged under any anti-avoidance provision which contains identical or similar wording. If, as a result of the consultation process which the Chancellor of the Exchequer is instituting, a general statutory anti-avoidance provision is introduced into United Kingdom law, the decision will be more important than ever.[3] In this article, I consider the new approach and the extent to which it involves a departure from the principles laid down by the Privy Council in *Commissioner of Inland Revenue v Challenge Corporation Ltd*[4] and apparently approved by the House of Lords in *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)*.[5]

2.3 The Judicial Lottery

Thirdly, by complete contrast with *IRC v McGuckian*,[6] the speeches in which had been delivered only four weeks earlier, there was no hint of anti-taxpayer bias. On the contrary, their Lordships appear to have leant over backwards to accommodate the worthy Professor. On the first point, they impliedly rejected any purposive construction of the statute and found that the construction for which his counsel contended was the "inevitable" one, albeit recognising that a differently constituted Appellate Committee had, fifty years earlier in *Congreve v IRC*,[7] formed a diametrically opposed view! On the second point, they took a narrow view of "tax avoidance".

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3 In this article, I concentrate on the general question of what is meant by "tax avoidance". For a discussion of the section 739 aspects of *Willoughby* the reader is referred to my companion article shortly to be published in *The Offshore Taxation Review*, 'Tax Avoidance after *Willoughby*' Volume 7, Issue 3, at page 139.

4 [1986] STC 648.

5 [1992] STC 226.

6 See my article earlier in this issue 'The *Ramsay* Doctrine after *McGuckian*'.

7 30 TC 163.

In each case there was an Appellate Committee of five Law Lords. Only one Lord of Appeal in Ordinary, Lord Clyde, served on both Committees. He was one of the "doves" in *McGuckian*. One of the Appellate Committee in *Willoughby* was Lord Hutton, who, as Hutton CJ, had been one of the judges of the Court of Appeal in Northern Ireland who had been reversed by the House of Lords in *McGuckian*! A very encouraging sign for taxpayers is that another of the Appellate Committee in *Willoughby* was the Chancery judge, Lord Hoffmann, a former Oxford law don and a formidable intellect, who in the past has sometimes given the impression that he is prepared to construe tax statutes robustly in order to defeat tax avoidance.

The moral to be drawn from the two decisions is that the result in any sensitive case, especially one involving the difficult distinction between tax mitigation and tax avoidance, may involve a large element of pure chance, depending on how the tribunal seised of the matter happens to be constituted. This is one of the perhaps inevitable consequences of the growth in the numbers of the judiciary in recent years. For taxpayers with a weak case, there is an incentive to "have a go", especially when the amounts at stake are large in proportion to the costs involved. For taxpayers with strong cases, the increase in the randomness factor makes the probability of the outcome the more difficult to determine.

The lack of clearly defined principles consistently applied also involves the inherent danger of irrational and undemocratic factors being taken subconsciously into account. Countesses preserving their ancestral wealth from capital taxation and modestly-paid professors managing their unapproved pension fund may fare better than entrepreneurs or pop stars. No tax adviser should ever underestimate the element of what barristers call “prejudice”.

3 Avoiding Liability to Taxation

The restricted meaning their Lordships gave to "avoiding liability to taxation" will, if it is followed, have far-reaching consequences. Professor and Mrs Willoughby had taken out further bonds with an offshore insurer at a time when they were ordinarily resident in the United Kingdom. They claimed that section 739 did not apply, because of section 741, which allows the taxpayer to escape if he can prove, inter alia, that “the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected”.

Their Lordships accepted "as a generally helpful approach to the elusive concept of ‘tax avoidance’ the submissions of Launcelot Henderson QC on behalf of the Revenue that the hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such a reduction in his tax liability; whereas the hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation and genuinely suffers the economic consequences Parliament intended to be suffered by those taking advantage of the option. The immediate ancestry of this concept is the speeches of Lords Templeman and Goff in *Ensign Tankers (Leasing) Limited v Stokes*.[8] The remoter ancestry is the much fuller opinion of the majority of the Judicial Committee of the Privy Council in *Commissioner of Inland Revenue v Challenge Corporation Ltd*,[9] delivered by Lord Templeman.

4 *Commissioner of Inland Revenue v Challenge Corporation Ltd*

4.1 The Issue

The context in which the discussion arose was the possible application of the New Zealand general anti-avoidance provision to the buying into a group of companies of a company with tax losses with a view to their being surrendered by way of group relief. The anti-avoidance provision was the Income Tax Act 1976 section 99, which provided that any 'contract' shall be 'absolutely void as against [the Commissioner of Inland Revenue] if and to the extent that, directly or indirectly, its purpose or effect [is to reduce] any liability to income tax'.[10] *Challenge* contended that because it did not fall foul of the more specific anti-avoidance provision contained in the group relief legislation, in particular section 191,[11] then section 99 did not apply. Three of the four judges in New Zealand found for the taxpayer. They included Cooke J, now Lord Cooke of Thorndon, who in *IRC v McGuckian* has given the impression that he will be a thorn in the flesh to taxpayers! The Privy Council found for the Commissioner of Inland Revenue, Lord Oliver dissenting. That the nine judges were split five-four shows that general statutory anti-avoidance provisions are not without their problems of interpretation. As Lord Oliver remarked in his dissenting speech: "even the commissioner concedes that section 99, albeit expressed in the widest possible terms, has to be read subject to some limitation as regards transactions permitted

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8 [1992] STC 226.

9 [1986] STC 648.

10 Section 99 is set out in the Appendix to this article.

11 Section 191 is set out in the Appendix.

or authorised by other legislative provisions if it is not to produce results that are absurd."

4.2 Sham, Evasion, Mitigation and Avoidance

Lord Templeman delivered the Opinion of the majority of the Judicial Committee He distinguished four types of transaction:

(a) a transaction which is a sham;

(b) a transaction which effects the evasion of tax;

(c) a transaction which mitigates tax; and

(d) a transaction which avoids tax.

A sham, he correctly observed, is something which is "so constructed as to create a false impression in the eyes of the tax authority". There was no sham in *Challenge* because "the appearance created by the documentation was precisely the reality".

Tax evasion, Lord Templeman declared, "occurs when the commissioner is not informed of all the facts relevant to an assessment of tax". He distinguished between "innocent evasion" which "may lead to a reassessment" and "fraudulent evasion, which may lead to a criminal prosecution as well as reassessment". There was no evasion in *Challenge*. Normally, the term "evasion" is used only of fraudulent evasion. I know of no other authority where the concept of "innocent evasion" has been employed.

4.3 The Distinction between Mitigation and Avoidance

The material distinction in *Challenge* was between tax mitigation and tax avoidance. Lord Templeman tried to explain the difference.

> "A taxpayer has always been free to mitigate his liability to tax. In the oft quoted words of Lord Tomlin in *IRC v Duke of Westminster* [1936] AC 1 at 19, 19 TC 490 at 520 'Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Act is less than it otherwise would be'. In that case however the distinction between tax mitigation and tax avoidance was neither considered nor implied."

By this last sentence, Lord Templeman is suggesting that while a man is free to mitigate his tax liability, he is not free to avoid it, at least if Lord Templeman has anything to do about it! This tells us something about the different consequences which attach to the two, but does not help us to distinguish between them except where there is a binding precedent characterising a transaction as falling on one side of the line or the other. His Lordship made a valiant attempt at designing such a test:

> "Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. Section 99 does not apply to tax mitigation because the taxpayer's tax advantage is not derived from an 'arrangement' but from the reduction of income which he accepts or the expenditure which he incurs."

4.4 Judicial Ingenuity

The reason why section 99 is said not to apply is pure judicial invention. On its clear wording, section 99 applies to every transaction the effect of which is to cause a reduction in liability to income tax. The section says nothing about the reduction of income or the incurring of expenditure. It does not even require a tax avoidance motive. It is enough that the *effect* of the transaction is to reduce a liability to income tax. Nor is there in terms any bona fide commercial motive defence.

The problem with the section is that it covers far too much. Hence, judges feel obliged to intervene in order to prevent nonsense or chaos or both. They are bound to adopt criteria which are not laid out in the statute. These criteria may or may not be suitable. In this case, Lord Templeman reasoned that where an arrangement gives rise to a reduction in an income tax liability only because there is a corresponding diminution in income then the reduction is not "derived from"[12] the arrangement. Yet if the reduction would not have happened but for the arrangement, how can that be? No doubt, if pressed, Lord Templeman would say that the arrangement was not the *true* cause of the reduction in tax liability. He might, in the medieval Latin of the tort lawyer, say that the arrangement was the *causa sine qua non* but not the *causa causans* of the tax reduction.

4.5 Covenanted Payments

Lord Templeman then gave illustrations:

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12 These words are a gloss on the statutory language "the effect of".

> "Thus when a taxpayer executes a covenant and makes a payment under the covenant he reduces his income. If the covenant exceeds six years and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the payment under the covenant."

This is a little more complicated. It is only for reasons steeped in history that covenanted payments were ever deductible in the United Kingdom in computing the taxable income of the payer.[13] In many countries, such payments are regarded simply as applications of income which the payer has received, rather like the making of voluntary allowances, and do not result in any reduction in his tax liability. From 1920 onwards, Parliament enacted a series of anti-avoidance provisions restricting the deductibility of such payments or negativing such deductibility by providing that the payments should be deemed to be taxable income of the payer rather than of the payee.[14] The real reason, I would suggest, why covenanted payments which are still deductible would not be caught by a general anti-avoidance provision is that they have been the subject of such intense and continuing Parliamentary attention that no one could deny that Parliament desires that those covenanted payments which currently escape the general prohibition on deductibility should continue to be deductible and that any tax advantage which is thereby secured is one which Parliament wishes to be obtained.

4.6 Settlements

Lord Templeman continued:

> "When a taxpayer makes a settlement, he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income."

Again, in my view, the real reason why income arising under a settlement would not be caught by a general anti-avoidance provision is that settlements have likewise been the subject of such intense and continuing Parliamentary attention that no one could deny that Parliament intends that income arising under a

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13 See *IRC v Frere* 42 TC 125.

14 In 1986, these were contained in Income and Corporation Taxes Act 1970 Part XVI (Settlements). The law has undergone much change since. Apart from charitable covenants, most covenanted payments made under obligations incurred since 1988/89 are now ignored for income tax purposes, both as regards the payer and the payee.

settlement which is not deemed to be that of the settlor under some limited anti-avoidance provision[15] should not be caught by a general anti-avoidance provision. As an example, if I set up a settlement under which I am excluded from benefit, the income arising is still deemed to be mine, by virtue of one or more anti-avoidance provisions, if the lady entitled to the income is my wife but not if she is my live-in lover. If a general anti-avoidance provision were to be introduced, the Revenue could not claim in the latter case to tax me on her income simply on the grounds that, were it not for tax considerations, I would not have set up the settlement but would have simply have maintained her out of resources which I had retained.

4.7 Privileged Savings

Lord Templeman continued:

> "Where a taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitled the taxpayer to reduction of tax liability. The tax advantage results from the expenditure on the premium."

This is, at first glance, an easy case. If Parliament has gone out of its way to state that if certain expenditure is incurred then the payer shall obtain a tax allowance, it is most unlikely to be its intention that relief shall be denied by a general anti-avoidance provision, even if the taxpayer would not have incurred the expenditure but for the tax allowance.

The illustration is now a little dated in the United Kingdom as Life Assurance Premium Relief is not available on policies taken out after 1984. The principle applies, however, to any form of tax-efficient savings, such as contributions to an exempt approved pension scheme. Thus, it should not matter that the taxpayer has to borrow to pay his pension contribution and that, but for the tax savings, the borrowing would make not commercial sense, in that the return from the pension fund would be less than the cost of the borrowing.

4.8 Qualifying Expenditure

Lord Templeman then mentioned tax-efficient expenditure, to which much the same principles apply as tax-efficient saving:

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15 In particular Income and Corporation Taxes Act 1988 Part XV (Settlements).

> "A taxpayer may incur expense on export business or incur capital or other expenditure which by statute entitles the taxpayer to a reduction of his tax liability. The tax advantages result from the expenditure for which Parliament grants specific tax relief."

Here, the considerations are very similar to those appertaining to tax-efficient savings. Even in this area, I apprehend that difficulties may still arise where the Courts consider that the express relief is being "abused". So far, they have limited themselves to applying Lord Templeman's test and denying relief on the grounds that the taxpayer has not really incurred the expenditure, which is a rule which is in principle perfectly fair and in practice not too difficult to apply.[16] It remains to be seen whether they might venture further afield on the grounds that "Parliament can never have desired that the relief should be available in such circumstances". If so, they would have to accept that Lord Templeman's exegesis in *Challenge* is not necessarily an exhaustive statement of the law.

4.9 Group Relief

4.9.1 The Decision in *Challenge*

Lord Templeman then considered the facts of *Challenge*:

> "When a member of a specified group of companies sustains a loss, section 191 allows the loss to reduce the assessable income of other members of the group. The tax advantage results from the loss sustained by one member of the group and suffered by the whole group.
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> "Section 99 does not apply to tax mitigation where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability.
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> "Section 99 does apply to tax avoidance. Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.

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16 The most important example is *Ensign Tankers (Leasing) Limited v Stokes*, discussed below.

> "In the present case the taxpayer subsidiaries seek to reduce their assessable income by a loss of $5.8m which was sustained by Perth [the company which was bought in] and suffered by Merbank [the vendor company] and was not sustained by the taxpayers or suffered by Challenge. It is true that Challenge expended $10,000 in purchasing the shares in Perth but this purchase price is not deductible against Challenge's assessable income. Apart from the risk of losing $10,000, the Challenge group never risked anything, never lost anything and never spent anything but now claim to deduct a loss of $5.8m. Challenge have practised tax avoidance to which section 99 applies. Challenge have not practised tax mitigation because the Challenge group never suffered the loss of $5.8m which would entitle them to a reduction in their tax liability of $2.85m. The tax advantage stems from the arrangement with Merbank and not from any loss sustained by Challenge or the Challenge group.
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> "It was argued that if this appeal by the commissioner succeeds a purchase of shares in a company which becomes part of a specified group will always be void under s 99. But a purchase of shares will only be void in so far as it leads to tax avoidance and not tax mitigation.
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> "In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax."

4.9.2 Critique

Now Lord Templeman's expenditure test does not fit without some tailoring to the case of group relief. It is the essence of group relief that one taxpayer obtains a tax deduction because another taxpayer has incurred expenditure, which either results in a real loss or is of the type which it is Parliament's intention should qualify for a tax deduction. The implied premise in Lord Templeman's reasoning is that the group which benefits from the tax deduction should, viewed as a whole, have sustained the loss or incurred the expenditure and that Parliament cannot have intended that losses should be capable of surrender where the surrendering company had incurred them at a time when it was outside the group for whose benefit the surrender was being made. This he stated more clearly towards the end of his judgment: "In order to escape section 99 a transferable loss must be sustained by a member of a group which suffers the loss."

This reasoning is not without its difficulties. Where, as in United Kingdom law, there are express rules within the group relief provisions which provide for the position where a company joins or leaves a group, it is more difficult to say that Parliament would not desire that relief should be given in a case where, on an application of those rules, it is clearly available. In saying that there is tax avoidance in this, or indeed any other, case, the courts are going beyond construing what Parliament has enacted and are trying to divine thoughts which Parliament kept in its theoretical breast and did not articulate. This is an exercise which they have traditionally eschewed and still generally eschew, even in these days where purposive construction is regarded as more important than literal construction. It is of course in reality an impossible exercise. It comes down to the courts deciding, on the most exiguous of materials, what otherwise lawful and effective reduction in tax Parliament would have thought unacceptable if it had thought about the matter. The decision is all the more difficult in that, *ex hypothesi*, the courts will already have found that the intention of Parliament as discerned by construing the taxing statutes was that, subject only to the statutory or judicial anti-avoidance rule which is being applied, tax should not be paid in the given circumstances.

Where there is an obvious loophole caused by defective drafting, the matter is not difficult. Yet many cases are not so simple. Take group relief itself. Is it so obvious that, as Lord Templeman thought, a group should not be able to buy in losses? After all, the losses are genuine losses. The Revenue cannot complain that it is globally receiving tax on anything less than the balance of profits and losses in fact made. It may well have been Parliament's intention to encourage hazardous ventures which might result in loss by conferring on the proprietors of a company which is tax-exhausted the option of at least being able to sell it for its losses to another group which was in a position to use them. This might indeed be the only way to encourage an ailing fledgling industry.

Returning to section 99 of the New Zealand Income Tax Act and to the taxpayer's argument that a purchase of shares in a company which becomes part of a specified group will always be void under the section, Lord Templeman's reply that "a purchase of shares will only be void in so far as it leads to tax avoidance and not tax mitigation" is at first blush unconvincing. The motive of the acquiring group will not matter. It will still be denied group relief even if it acquired for bona fide commercial reasons quite divorced from any tax considerations. Lord Templeman's answer would no doubt be that in the context of section 99 one is concerned with the *effect* of the transfer; if, section 99 apart, it results in a reduction in tax liability, then there is "avoidance" as defined and the reduction is negatived. Where one is dealing with different anti-avoidance provisions, such as those to which we are more accustomed in the United Kingdom, where motive is an essential ingredient, then whether or not a reduction in tax liability is counteracted will indeed depend on whether there exists that essential ingredient of the meaning of the plain English word "avoidance", namely, an intention to avoid.

4.10 *Duke of Westminster*

Lord Templeman continued by mentioning three cases where it is difficult to disagree that there was tax avoidance:

> "In *IRC v Duke of Westminster*, the Duke avoided tax by reducing his assessable income without reducing his income by the method of substituting an annuity for a wage payable to his gardener. So long as the gardener continued to work, the Duke gained a tax advantage over other taxpayers who paid wages to their working gardeners."

There was no doubt that the Duke only entered into the transaction to reduce his tax liability. There was equally no doubt that if Parliament had been asked whether it wished persons in the Duke's position so to be able to reduce their tax liability, the answer would have been a resounding "No". The difficulty I have always had with the case[17] is in seeing how the scheme ever worked technically. For although the Duke covenanted to pay his employees sums of money, it is to my mind quite clear that they were paid as a reward for services and thus chargeable under Schedule E, to the exclusion of Schedule D Case III, so that the Duke was not allowed to deduct the payments from his taxable income.

4.11 *Black Nominees*

Lord Templeman then mentioned the second tax avoidance case:

> "In *Black Nominees Ltd v Nicol (Inspector of Taxes)*[18] an actress sought to avoid income tax by reducing her assessable income without reducing her income. She converted her earnings into instalments of capital by a number of transactions each designed to take advantage of some specific exemption or relief provision of the taxing statute. She attempted to obtain a tax advantage over other actresses and other taxpayers who paid tax on their earnings."

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17 I do not, of course, have any difficulty with the general principle for which the case is usually cited.

18 [1975] STC 372, 50 TC 229.

This is a little misleading. The whole point of the scheme was that Julie Christie *was* seeking to reduce her "income", whether it was assessable income or "income" in some more general sense. She was giving up a right to income and taking benefits in a "capital" form which her advisers thought were not taxable. (Templeman J held they were wrong as a matter of substantive law.) The case is an example of the type of tax planning which tries to convert a taxable profit into a non-taxable profit and with which the *Challenge* test cannot cope. Such a strategy may or may not amount to "tax avoidance" in Lord Templeman's language. I might, for example, decide to pay contributions into a personal pension scheme and obtain a tax deduction and benefit from tax reliefs on the income and gains of the scheme precisely because at the end of the day I shall be able to take out a certain amount of tax-free capital into which the income has been transmogrified, yet that is clearly not "tax avoidance" because it is precisely what Parliament intends I should be able to do.

4.12 *Chinn v Collins*

Lord Templeman then considered the third case, the decision in which is justifiable only if it is viewed as a harbinger of *Ramsay*:

> "In *Chinn v Collins (Inspector of Taxes)*[19] the trustees and beneficiaries under a settlement attempted to avoid capital gains tax payable on the distribution of trust property. By a number of transactions each designed to take advantage of some specific exemption or relief provision of the taxing statute, the beneficiary entitled to trust shares was converted into a purchaser of the shares without involving him in the expenditure of a purchase price. The beneficiary attempted to obtain a tax advantage over other beneficiaries who paid capital gains tax when they became entitled to trust property."

The explanation of this complex case is, understandably, over-compressed. The key point is that beneficiaries about to become absolutely entitled to shares in an offshore trust entered into a serious of transactions as a result of which they become entitled to the shares but not as beneficiaries, so that, it was argued, they avoided having gains realised by the trustees imputed to them. No one could doubt that Parliament would never have wished their scheme to work.

4.13 The *Ramsay* Principle

Lord Templeman then discussed *Ramsay* and *Burmah Oil*:

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19 [1981] STC 1, [1981] AC 533.

> "In *Ramsay v IRC and Eilbeck (Inspector of Taxes) v Rawling*,[20] the taxpayers attempted to avoid capital gains tax by making a deductible loss matched by a non-chargeable gain and setting off the loss against a pre-existing chargeable gain. In reality the taxpayer did not make any loss. The taxpayer attempted to obtain a tax advantage over other taxpayers who paid capital gains tax on chargeable gains.
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> "In *IRC v Burmah Oil Co Ltd*,[21] the House of Lords refused to accept that the taxpayer 'had achieved the magic result of creating a tax loss that was not a real loss'; per Lord Fraser of Tullybelton. Lord Scarman said (at 39) that in considering any tax avoidance scheme 'it is now crucial ... to take the analysis far enough to determine whether a profit, gain or loss is really to be found'."

Few would deny that tax avoidance was involved in *Ramsay*, where the taxpayers tried to create an allowable loss out of thin air. I have much more sympathy with the Burmah Oil Co Ltd, in that they were trying to convert what the legislation quite unfairly said was a non-allowable loss into an allowable loss. I have even more sympathy when I reflect that the loss could so easily have been an allowable loss had proper steps been taken in time. Yet for all that, the company was likewise trying to produce an allowable loss by an artificial exercise.

4.14 Lord Templeman Nods

Lord Templeman then made a most extraordinary statement:

> "Most tax avoidance involves a pretence; see the analysis in *Ramsay v IRC* [1979] STC 582 at 583, [1979] 1 WLR 974 at 979. In the present case Challenge and their taxpayer subsidiaries pretend that they suffered a loss when in truth the loss was sustained by Perth and suffered by Merbank."

Here, his Lordship was, like Homer, nodding. His statement is flatly inconsistent with what he had said earlier about there being no sham.[22]

4.15 Lord Templeman's Conclusion

Lord Templeman concluded:

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20 [1981] STC 174, [1982] AC 300.

21 [1982] STC 30 at 39.

22 See 4.2 above.

"In New Zealand section 99 would apply to all the cited English cases of income tax avoidance. Section 99 also applies where, as in this case, the taxpayer alleges that he has achieved the magic result of creating a tax loss by purchasing the tax loss of another taxpayer.

"Whatever the circumstances or complications, if a taxpayer asserts a reduction in assessable income, or if a taxpayer seeks tax relief without suffering the expenditure which qualifies for such relief, then tax avoidance is involved and the commissioner is entitled and bound by section 99 to adjust the assessable income of the taxpayer so as to eliminate the tax advantage sought to be obtained."

4.16 Lord Oliver

Lord Oliver in his dissenting speech first remarked that "even the commissioner concedes that section 99, albeit expressed in the widest possible terms, has to be read subject to some limitation as regards transactions permitted or authorised by other legislative provisions if it is not to produce results that are absurd."

He continued:

"As regards [this] consideration ..., the example given in the course of argument was that of the simple gift of income to, for instance, a grandchild of the donor or to a charity by way of deed of covenant. The Board's attention was not specifically drawn to any provisions of the New Zealand legislation equivalent to those of the United Kingdom Income Tax Acts but the example will serve for present purposes. The commissioner concedes that section 99 does not strike down such an arrangement, even though it undoubtedly has as one of its purposes the alteration of the incidence of tax and the reduction of the total tax payable and so would, prima facie, constitute 'tax avoidance'. The reason why this is so was said to be that the primary purpose of the arrangement was simply the gift of income and the reduction of the donor's income as a result of the gift, the reduction of tax payable merely being 'an incidental purpose or effect'.

With respect to those who take the contrary view, I find this too facile an argument. No doubt the donor's purpose is to make a gift to the donee and thus to that extent to reduce his own income, but there are ways of producing that result which would have no effect on the tax position of either the donor or the donee and which would not have the effect of reducing in any way the total amount of tax payable. The purpose and, generally, the sole purpose of effecting the transaction by deed of covenant is to bring into being a contractual obligation which will enable the donor

> to treat the income given as excluded from his income, which will cause the income given to be treated as that of the donee, and which, in the case of a charity, will enable the donee to recover from the Revenue the tax which the donor is obliged to deduct and pay to the Revenue. Those consequences are not in any sense 'incidental' to the making of the gift. They are the be-all and end-all of making the gift by that particular form of transaction. The consequences of making gifts of income in this way are statutory consequences provided for, and deliberately provided for, in the legislation and to treat them as avoided by the ex facie unlimited terms in which section 99 is expressed would result in the absurdity that a statutory code provided by the legislature expressly for the purpose of relieving the donated income of tax would be effectively deprived of any sensible sphere of operation."

I would respectfully agree with Lord Oliver that where the statutory consequences of entering into a transaction are deliberately provided for, then Parliament can hardly have regarded as tax avoidance deliberately obtaining a favourable treatment within those rules. This aspect was to be taken up the House of Lords in *Willoughby*. As Lord Nolan put it in *Willoughby*: "it would be absurd in the context of [Taxes Act 1988 section 741] to describe as tax avoidance the acceptance of an offer of freedom from tax which Parliament has deliberately made."

I do not imagine that Lord Templeman would really disagree with Lord Oliver about the case of donated income. The problem is that we cannot always be sure precisely when a statutory code provided by the legislature expressly for the purpose of conferring reliefs accurately gives effect to the desire of Parliament and when it contains loopholes. The case of the donated income is an easy one because the legislation is so detailed that it is most unlikely that it does contain loopholes. The New Zealand group relief provisions gave rise to a 5-4 division of opinion between the judges in *Challenge*.

In my view, where there is a self-contained code with its own conditions and anti-avoidance provisions, one should treat anything done to bring a taxpayer within its terms as not constituting tax avoidance unless it is quite clear that Parliament would not have wished the tax advantage to be obtained. As Lord Nolan said in *Willoughby*: "Tax avoidance within the meaning of [Taxes Act 1988] section 741 is a course of action designed to conflict with or defeat the *evident*[23] intention of Parliament."

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23 Italics supplied.

5 *Ensign Tankers (Leasing) Ltd v Stokes (Inspector of Taxes)*,[24]

5.1 The Facts and Issues

Ensign became a partner in a limited partnership set up to finance the production and exploitation of a film which embarked on a series of transactions in respect of the film in order to take advantage of 100% first-year capital allowances. The partners claimed capital allowances for expenditure of $14,000,000 although the partners were never liable to spend more than $3,250,000 of their own money. They "borrowed" the $11,750,000 on a non-recourse "loan". The lender was to receive 75% of the net receipts from the exploitation of the film, whether this was less or greater than the amount of the "loan". This was held to be in reality no loan at all. The "lender" had bought a 75% equity participation. The taxpayers had expended only the $3,250,000 and were thus entitled to allowances on only that amount. As Lord Templeman[25] put it: "The transaction was a joint venture and contained no element of loan."[26]

5.2 A Tax Avoidance Motive does not Prevent Trading

The Revenue had claimed that because the partners were engaged in a tax avoidance exercise they could not be trading and hence on that account were entitled to no capital allowances. The House of Lords decided that the production and exploitation of a film was a trading activity and that the fact that it was entered into purely for tax avoidance reasons was irrelevant. They expressly rejected the tests laid down by Browne-Wilkinson MR in the Court of Appeal in *Ensign* that "if the [appeal] commissioners find as a fact that the sole object of the transaction was fiscal advantage, that finding can in law only lead to one conclusion, viz that it was not a trading transaction ... if the commissioners find as a fact only that the paramount intention was fiscal advantage ... the commissioners have to weigh the paramount fiscal intention against the non-fiscal elements and decide as a question of fact whether in essence the transaction constitutes trading for commercial

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24 [1992] STC 226.

25 Lords Keith and Brandon agreed with Lord Templeman, as did Lords Goff and Jauncey, who each added some comments of their own.

26 If it had really borrowed the $11,750,000 and was liable to repay it all in any event, the position would have been different.

purposes."[27]

5.3 Relevance of *Ramsay*

Thus the case was decided without any need to resort to the *Ramsay* principle and quite independently of the tax-avoidance motive. That did not prevent Lord Templeman from trying to bring in *Ramsay* and expatiating at some length on a number of authorities on tax avoidance.[28] His opening remarks were: "My Lords, this appeal is concerned with a tax avoidance scheme, a single composite transaction whereunder the tax advantage claimed by the taxpayer is inconsistent with the true effect in law of the transaction." His survey of the following cases did not throw any light on the meaning of "tax avoidance", merely on when such tax avoidance had been unsuccessful:

IRC v Duke of Westminster [1936] AC 1
FA & AB Ltd v Lupton (Inspector of Taxes) 47 TC 580
Black Nominees Ltd v Nicol (Inspector of Taxes) [1975] STC 372
Floor v Davis (Inspector of Taxes) [1978] STC 436
W T Ramsay Ltd v IRC [1979] STC 582
Chinn v Collins (Inspector of Taxes) [1981] STC 1
W T Ramsay Ltd v IRC; Eilbeck (Inspector of Taxes) v Rawling [1981] STC 174
IRC v Burmah Oil Co Ltd [1982] STC 30
Furniss (Inspector of Taxes) v Dawson [1984] STC 153
Craven (Inspector of Taxes) v White [1988] STC 476

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27 The message, alas, has not got through, at least at Special Commissioner level. In *N Ltd v Inspector of Taxes* [1996] STC (SCD) 346 Messrs Cornwell-Kelly and Horsefield QC denied group relief on alleged trading losses of £50,000,000. They rejected my submissions on behalf of the taxpayer that the fact that a company is trading in order to obtain a tax advantage does not mean that it is trading any the less. They held, at D.2 of their Decision, that what the House of Lords had said in *Ensign* applied only where there was an undoubted trade and that in determining whether there was a trade one went back to earlier authorities, in particular the dicta of Browne-Wilkinson MR in the Court of Appeal in *Overseas Containers (Finance) Ltd v Stoker* [1989] STC 364 where he had expressed similar views to those later rejected by the House of Lords in *Ensign*! N Ltd came to an arrangement with the Inspector of Taxes whereunder the decision was not to be appealed.

28 Likewise, Lord Goff based his decision in the alternative that the various arrangements were self-cancelling.

5.4 *Challenge*

The interesting passage in the present context is at page 240b-e:

> "The particular form of tax avoidance scheme with which the cases, *FA & AB Ltd v Lupton*, *Ramsay* and *Burmah* were concerned and with which this case is concerned consists of a scheme which seeks to obtain for a taxpayer a reduction in his taxable income without suffering any financial loss or expenditure. In *Commissioner of Inland Revenue v Challenge Corp Ltd* [1986] STC 548 at 554-555, [1987] AC 155 at 167-168 delivering the advice of the majority I drew a distinction between tax mitigation and tax avoidance in these terms:
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>> 'Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability ... Income tax is avoided ... when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction.'
>
> "The taxpayer company claims that Victory Partnership generated a first-year allowance of $14,000,000 without incurring the expenditure of $14,000,000. This is tax avoidance and falls within the principles of *Ramsay* and subsequent decisions of this House."

The passage is of importance in that it imports the *Challenge* principle from the Privy Council into the case law of the House of Lords, although how much extra authority is thereby conferred on it in the United Kingdom courts is debatable, given that it is not the *ratio* of the decision in *Ensign*.

It should be noted that in the last paragraph quoted, Lord Templeman is not saying that all tax avoidance falls within *Ramsay*. That was the Revenue argument that the House of Lords rejected in *Craven v White*. All his Lordship was saying was that because the scheme was both tax avoidance and fell within *Ramsay,* then it was caught by *Ramsay*. Which boils to saying that it was caught by *Ramsay* because it was caught by *Ramsay*.

5.5 *FA & AB Ltd v Lupton*

Lord Templeman's statement that *FA & AB Ltd v Lupton*[29] was concerned with a scheme which sought to obtain for a taxpayer a reduction in his taxable income without suffering any financial loss or expenditure shows, with respect, a lack of understanding of the strategy involved in the case. The tax advantage was sought not by the appellant but by shareholders in companies pregnant with distributable profits. It was these shareholders who wished to enjoy those profits in a non-taxable form. They therefore sold them for a capital sum[30] to the appellant, a dealer in shares, which claimed to have acquired them as trading stock. When the dividend was paid to the appellant it formed part of its taxable income. There was a corresponding diminution in the value of the shares, which diminution was, if the appellant was right, deductible in computing the trading profits of the appellant. Hence, the appellant would have been charged to tax on the overall commercial profit it made from the transaction and on that alone.[31] It was not seeking any tax deduction for any unreal loss. The appellant did not avoid any tax for itself. The Revenue were concerned because the appellant was enabling the vendor shareholders to avoid tax. They hence attacked it on the basis that the acquisition of the shares were not trading transactions, so that the shares were not held by it as trading stock and their diminution in value was thus not tax-deductible. It was that contention which the House of Lords upheld.

In cases like this, the *Challenge* test is inadequate. It is not a question of whether anyone seeking a tax allowance has or has not really incurred expenditure or sustained a loss. The taxpayer has the choice of taking a profit in a taxable form (a dividend) or in a non-taxable form (sale of shares including the right to future dividends). To determine whether his choice of the non-taxable form amounts to tax avoidance requires rather more sophisticated tools of analysis than any provided by *Challenge*. Indeed, there can be no unique answer to such a question. The reader might feel tolerably satisfied that on the facts of *Lupton*, which were even more complicated and artificial than mentioned above, it was evident that Parliament did not desire that the shareholders should escape tax.

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29 47 TC 580.

30 The schemes were effected prior to the introduction of capital gains tax. They are now scuppered by Income and Corporation Taxes Act 1988 Part XVII Chapter 1.

31 The appellant bought the shares at such a price that it would make a "turn". This factor in my view makes the House of Lords decision rather very suspect. Was not the appellant undoubtedly trading, even if the trade was only one of providing tax avoidance facilities? This point is not, however, germane in the context of the present discussion.

5.6 Bed and Breakfasting

Lord Templeman continued:

> "There is nothing magical about tax mitigation whereby a taxpayer suffers a loss or incurs expenditure in fact as well as in appearance. A taxpayer who carries out a 'bed and breakfast' transaction by selling and repurchasing shares establishes a loss for capital gains tax because he has actually suffered that loss at the date of the transaction."

Lord Templeman's acceptance of bed and breakfasting is interesting.[32] It involves the proposition that realising an inherent real gain or real loss prematurely to improve one's tax position is tax mitigation rather than tax avoidance. This is another instance where the message has not got through at Special Commissioner level.[33]

5.7 Back to Back Transactions

Lord Templeman continued:

> "In 'back to back' transactions the taxpayer is entitled to any reduction in tax which Parliament has attached to each transaction. In the present case if LPI had been a British company, the fact that LPI borrowed $10,750,000 from Chemical Bank to enable LPI to make the film would not have denied to LPI a first-year allowance equal to the sums borrowed and expended."

Lord Templeman's reference to "back to back" transactions seems almost too good to be true. It is to my mind rather too vague for any substantial reliance to be placed on it. Where these transactions are connected with inward investment into the United Kingdom, such as those which involve the conversion of income taxable under Schedule A into interest with a Schedule D Case IV source not taxable in the hands of a non-UK resident, one quite understands why the Revenue are not

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32 I am told by D C Potter QC that when he raised *arguendo* before the House of Lords in *Ramsay* the point that the new doctrine would catch bed and breakfasting, he was told flatly by Lord Wilberforce that it was perfectly acceptable, for the best of reasons: "We do it."

33 In *N Ltd v Inspector of Taxes* [1996] STC (SCD) 346 (see above) all that the group was trying to do was to realise real losses on real property by appropriating it to trading stock, in order to set them off against real gains on the disposal of shares. Yet Messrs Cornwell-Kelly and Horsefield QC rejected my submissions on behalf of the taxpayer that this fiscal purpose was an entirely legitimate one and certainly did not prevent the relevant company from trading in the real property.

over astute to discourage the investment. It may well have been such transactions which Lord Templeman had in mind. In my view, one must still be very careful about back to back arrangements entered into by UK residents, where the attitude of the Revenue and of the Courts may be very different.

5.8 The *Duke of Westminster* Again

John Gardiner QC, for *Ensign*, had argued that although in substance the arrangement had the same commercial effect as an equity participation by the "lender", it was not such in law and the taxpayer was, under the *Duke of Westminster* principle, free to choose the fiscally more advantageous of the two technical means of achieving the same commercial end.[34] Lord Templeman's reply was:

> "In the present case the argument for the taxpayer company amounts to no more than a repetition of the dictum of Lord Tomlin in the *Duke of Westminster* case. Subsequent events have shown that though this dictum is accurate so far as tax mitigation is concerned it does not apply to tax avoidance."

This is way over the top. The dictum still applies to tax avoidance unless the tax planning falls foul of the *Ramsay* principle.

5.9 Lord Goff

Although Lord Goff agreed with Lord Templeman, he was more concerned with tax avoidance of the type caught by *Ramsay* than the *Challenge* principle. He said:

> "Like my noble and learned friend, Lord Templeman, I approach this case on the basis that there is a fundamental difference between tax mitigation and unacceptable tax avoidance. Examples of the former have been given in the speech of my noble and learned friend. These are cases in which the taxpayer takes advantage of the law to plan his affairs so as to minimise the incidence of tax. Unacceptable tax avoidance typically involves the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it may be, which otherwise would never have existed. These structures are designed to achieve an adventitious tax benefit for the taxpayer, and in truth are no more than raids on the public funds at the expense of the general body of taxpayers, and as such are unacceptable. Again examples have been given in the

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[34] The argument was accepted by Millett J at first instance.

> speech of my noble and learned friend. The question in the present case is into which of these two categories the transaction under consideration falls."

6 *IRC v Willoughby*

We left *Willoughby* at the end of section 3 with the submission of Leading Counsel for the Inland Revenue that the hallmark of tax mitigation is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation and genuinely suffers the economic consequences Parliament intended to be suffered by those taking advantage of the option.

In *Willoughby* their Lordships could so easily have taken the view that a person was engaging in tax avoidance if, faced with the choice of investing between an onshore insurance policy and an offshore insurance policy, the major, if not the sole, advantage of which was that the life fund of the insurer would grow free of United Kingdom taxes, thus resulting in a larger payment to the policyholder, he chose the offshore policy because it would give him a better return.

Yet they decided quite the opposite. Lord Nolan, after remarking that since 1st January, 1984 offshore policies could not be "qualifying" policies for United Kingdom tax purposes so as to escape a charge to United Kingdom on maturity under the Chargeable Event provisions, said: "In a broad colloquial sense tax avoidance might be said to have been one of the main purposes of those who took out [qualifying policies issued by non-UK resident companies] because plainly freedom from tax was one of the main attractions. But it would be absurd in the context of section 741 to describe as tax avoidance the acceptance of an offer of freedom from tax which Parliament has deliberately made. Tax avoidance within the meaning of section 741 is a course of action designed to conflict with or defeat the evident intention of Parliament."

One might ask, with respect to their Lordships, whether it can be sensibly considered that Parliament, in enacting in Finance Act 1984 that thenceforth no offshore policy should be a qualifying policy, was expressing the intention that holders of offshore non-qualifying policies should thenceforth be free from taxation under section 739 in respect of all such policies. Let us consider the history and purpose of the Chargeable Events legislation. Before the provisions were first enacted, a sum received on maturity, sale or surrender of a life policy would represent capital in the policyholder's hands and thus be exempt from income tax. (Life insurance policies have also been in general exempted from capital gains tax.) The only tax suffered would be that borne by the insurer on its life fund, which would normally be at a lower rate than a higher-rate taxpayer would suffer if he beneficially owned the assets underlying his policy. Parliament introduced the Chargeable Event provisions to charge higher-rate taxpayers at the higher rates only (allowing a credit for the basic rate tax) on disposals of their policies. In order to encourage saving, it considered that policies under which premiums were paid regularly and evenly over a long period should be exempted from this charge. Hence, it drew a distinction between "qualifying policies" and "non-qualifying policies", only the latter being subject to the charge. I am sure that in so doing it did not give any thought to offshore insurers at all, largely because between 1939 and 1979 exchange control regulations would normally have prevented individuals ordinarily resident in the United Kingdom from taking out such policies. It is to my mind utterly inconceivable that Parliament intended to provide a fiscal incentive for United Kingdom taxpayers to place their life insurance business abroad rather than in the United Kingdom.

As soon as exchange control was suspended by Margaret Thatcher in 1979, well-informed taxpayers began to perceive the advantage of taking out offshore policies, namely, that the pre-tax proceeds of disposal would be greater because the offshore company would not have borne United Kingdom tax on its life fund, yet there was no distinction between the taxation of the proceeds of onshore and offshore policies. It took the Revenue a mere four years to decide that something needed to be done. Finance Act 1984 provided that no new offshore policy should thenceforth be a qualifying policy and that when the holders of non-qualifying policies were chargeable under the Chargeable Event provisions they should no longer be given credit for basic rate tax.

Given that the qualifying policies legislation did not refer in any way to offshore policies, there must surely have been an argument that while an offshore policy might in principle constitute a "qualifying policy", all that meant was that the policy was not subject to the charge on disposal imposed by the non-qualifying policy provisions. Section 739 had existed, in one form or another, since 1936. It deals with transfers of assets generally whereby income becomes payable to persons domiciled or resident outside the United Kingdom. To my mind, it would have been quite extraordinary if their Lordships had held that the introduction of later anti-avoidance provision which deal with a very limited area, namely insurance policies, which impose a charge on some policies (non-qualifying policies) but not on other policies (qualifying policies) should somehow be construed as evidencing an intention on Parliament's part that policies not caught by the new provisions (qualifying policies) should thenceforth also be exempted from the effect of section 739.

In fact, none of the single premium bonds which Professor and Mrs Willoughby took out and which were the subject matter of the assessments under dispute could *ever* have been qualifying policies. (It is not altogether clear why Lord Nolan referred to qualifying policies at all.) Paradoxically, that makes their Lordships' conclusion rather easier to sustain. It is not at all implausible that, in subjecting offshore policies to one anti-avoidance regime, Parliament was impliedly relieving them from the section 739 regime, especially where no provision is made for the avoidance of double charges which would otherwise arise. Even this argument has its weaknesses, as subsequent events in this case showed: Professor Willoughby emigrated to Alderney before disposing of the policies and will thus, in my view, escape tax completely under the Chargeable Events provision, even as respects income which arose to the insurer while he was ordinarily resident in the United Kingdom.

7 Conclusion

The distinction made in *Challenge* between tax mitigation and tax avoidance is helpful so far as it goes, which is not as far as Lord Templeman supposed. It presupposes that a tax advantage is sought to be obtained by the gaining of a relief or deduction from one's taxable income. Yet many forms of tax planning are very different. Often, they involve taxpayers converting what would be taxable profits into profits or benefits which are not taxable.[35]

A fundamental difficulty with the doctrine is that it is necessary to ascertain the "intention" of Parliament. Now whenever one construes a statute, one is ascertaining Parliament's intention as expressed in the statute and the fact that nowadays the courts adopt a more robust approach to construction and pay less attention to the literal language of the statute and more to its purpose does not detract from this point. It is only when one has decided that the intention of Parliament[36] is that there shall be no charge to tax in the given circumstances that one can sensibly ask: has the taxpayer indulged in (prima facie successful) tax avoidance? That involves ascertaining the intention of Parliament not in the sense of discovering what it has enacted the rules shall be but in ascertaining what its attitude would be to the type of tax planning in question if it thought about the matter. It might be better, to avoid confusion, to speak of this intention as the "desire" or "wish" of Parliament and in this article I have tried to do so, wherever possible. Yet how does one do this given that one has gone beyond construing the statute?

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35 Or, at least, are not taxable so quickly or at so high a rate.

36 As ascertained before applying any statutory anti-avoidance provision which utilise the undefined concept of "tax avoidance" or some cognate expression.

A series of tests will need to be developed. In many cases, it is manifest that Parliament would never have wished the tax advantage to be obtained as the strategy depends on a loophole, an error or oversight in the drafting which Parliament would have corrected had it been pointed out at the Finance Bill stage. In other cases, it is manifestly clear that Parliament did intend the tax advantage to be obtained. Although most cases will fall in either of these two categories, there will be many interesting ones in the middle. *Challenge Corporation* and *Willoughby* could in my view have gone either way.

An important factor will be whether Parliament has made detailed provision in a certain area and in particular whether it has enacted specialised anti-avoidance provisions. *Pace* the majority in *Challenge*, in such a case there must be a strong presumption that conduct not falling foul of the anti-avoidance provisions is acceptable. Where the conduct in question is expressly exempted from the effect of the anti-avoidance provisions the presumption must be irrebuttable. For example, in general an absolute gift to one's spouse, although a "settlement", is expressly excepted from the application of the UK income tax Settlement Provisions.[37] No one could in my view say that the making of such a gift amounted to income tax avoidance.

In some cases, the position will not be clear. Parliament might have given a certain amount of attention to an area but not enough to enable one to discern with any degree of conviction whether it intended it to be a closed field so far as the application of general anti-avoidance doctrines are concerned. In such a situation, I would suggest that a lead be taken from Lord Nolan's speech in *Willoughby*: "Tax avoidance ... is a course of action designed to conflict with or defeat the *evident*[38] intention of Parliament." If it is evident that the intention (in the sense of the desire) of Parliament is being thwarted, then there is tax avoidance. If the intention is less than evident, so that one cannot be sure that it is being thwarted, then the taxpayer is to be given the benefit of the doubt. This is a not altogether undesirable state of affairs. Parliament pays considerable attention to its Finance Acts, which are set out in very great detail and contain many anti-avoidance provisions which do not rely on such general concepts as "tax avoidance". On top of that, the judicial doctrine in *Ramsay* will catch many a scheme. In many other cases, it will be obvious to all concerned that Parliament would find the tax planning unacceptable. In those cases where the position is not clear, it is only constitutionally proper that the courts revert to the old principle, which has never been subverted as such, that the subject is only to be taxed if the intention to do

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37 Taxes Act 1988 section 660A(6).

38 Italics supplied.

so is clear. If in any particular case Parliament does not like the result it can always legislate more clearly for the future.

8 Problem Cases

I leave my readers with some brain-teasers.

Teaser A

To what extent would the Revenue in Cases 1 - 4 be able to uphold assessments before the same Appellate Committee? Each strategy is undertaken either by A, an individual domiciled and ordinarily resident in the United Kingdom at all material times or by B Ltd, a corporation resident in the United Kingdom at all material times.

Case A.1

A buys a material interest in an offshore fund. The Revenue assess him under section 739 on a corresponding part of the income of the fund. (A is assessable to income tax on disposal of his interest under Taxes Act 1988 Part XVII Chapter V.)

Case A.2

A transfers his investment portfolio to an offshore company in exchange for shares and debentures. The Revenue assess him under section 739 on the income of the company. (A will be liable to income tax on dividends and interest from the company and to capital gains on the disposal of his shares in the company.)

Case A.3

A transfers his investment portfolio to the offshore trustees of a discretionary trust of which he is a beneficiary. The Revenue assess him under section 739 on the income of trustees. (The income of the trustees will be deemed to be his by virtue of Taxes Act 1988 Part XV.)

Case A.4

B Ltd transfers investments to a wholly-owned offshore company. The Revenue assess it to corporation tax under Taxes Act 1988 Part XVII Chapter IV (controlled foreign companies) on the income of the offshore company. (B Ltd will be liable to corporation tax in respect of dividends and interest from the offshore company and in respect of capital gains from a disposal of its shares in the company.)

Teaser B

To what extent has C engaged in tax avoidance in the following cases?

Case B.1

C owns shares which have not altered in value since he inherited them from his wife who died six months ago. A large dividend is about to be declared. C sells the shares to avoid paying income tax on the dividend, knowing that he is not liable to capital gains tax.

Case B.2

C wishes to make provision for his former nanny who has fallen on bad times. He wishes to set up a trust under which she is entitled to the income for her life but is informed that if he does so he will be taxable on the income payable to her. He therefore buys her an annuity from an insurance company.

Case B.3

C wishes to occupy his house during his lifetime but for it to pass to his children after his death as free from inheritance tax as possible. He therefore grants a lease for twenty-one years to a trust under which he has a life interest, with remainders over to his children and then gifts the freehold.[39]

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39 It appears that Millett LJ would consider that the *Ramsay* doctrine would not apply: see *Lady Ingram's Executors v IRC*, Court of Appeal, 28th June 1997, as to which I shall say no more as leave to appeal to the House of Lords has been given and I am counsel for the Executors.

APPENDIX

Extracts from New Zealand Income Tax Act[40]

Section 99 (Agreements purporting to alter incidence of tax to be void)

(1) For the purposes of this section:

"Arrangement" means any contract, agreement, plan, or understanding (whether enforceable or unenforceable) including all steps and transactions by which it is carried into effect:

"Liability" includes a potential or prospective liability in respect of future income:

"Tax avoidance" includes:

(a) Directly or indirectly altering the incidence of any income tax:

(b) Directly or indirectly relieving any person from liability to pay income tax:

(c) Directly or indirectly avoiding, reducing, or postponing any liability to income tax.

(2) Every arrangement made or entered into, whether before or after the commencement of this Act, shall be absolutely void as against the Commissioner for income tax purposes if and to the extent that, directly or indirectly,

(a) Its purpose or effect is tax avoidance; or

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40 The sections are set out as they stood in the relevant income tax year ended 31st March 1978.

(b) Where it has two or more purposes or effects, one of its purposes or effects (not being a merely incidental purpose or effect) is tax avoidance, whether or not any other or others of its purposes or effects relate to, or are referable to, ordinary business or family dealings,

whether or not any person affected by that arrangement is a party thereto.

(3) Where an arrangement is void in accordance with subsection (2) of this section, the assessable income and the non-assessable income of any person affected by that arrangement shall be adjusted in such manner as the Commissioner considers appropriate so as to counteract any tax advantage obtained by that person from or under that arrangement...

Section 191 (Companies included in a group of companies)

(1) For the purposes of this section:

(a) Where a nominee of any person holds any paid-up capital, or any allotted shares, or any voting power in a company, or is entitled to a share of profits distributed by a company, that paid-up capital, or those allotted shares, or that voting power, or that title to profits, as the case may be, shall be deemed to be held by that person:

(b) Shares in one company held by another company shall be deemed to be held by the shareholders in the last-mentioned company:

(c) The proportion of the paid-up capital, and of the nominal value of the allotted shares, and of the voting power, and of the title to profits held by any person in any company at the end of any income year shall be determined by the Commissioner; and

(i) In determining those proportions, the Commissioner shall disregard any alteration in those proportions which, in his opinion, is of a temporary nature and has or purports to have the purpose or effect of in any way -

(A) Altering the incidence of income tax; or

(B) Relieving the company or any other company from its liability to pay income tax, by in either case excluding that company or any other company from, or including that company or any other company in, any group of companies in relation to that income year...

(2) Subject to this section, every company included in a group of companies shall be assessable and liable for income tax in the same manner as if it were a company not included in a group of companies.

(3) Where, in relation to two or more companies and to any income year -

(a) The aggregate of the prescribed proportions of the paid-up capital, or of the nominal value of the allotted shares, or of the voting power, in each of those companies which is held by the same persons is not less than two-thirds of the paid-up capital, or of the nominal value of the allotted shares, or of the voting power, as the case may be, in each of those companies; or

(b) The aggregate of the prescribed proportions of the profits for that income year of each of those companies to which the same persons would be entitled if the profits of each of those companies were distributed by way of dividend at the end of that income year is not less than two-thirds of those profits of each of those companies;

those companies (in this Act referred to as a group of companies) shall, in respect of that income year, be assessed and liable for income tax in accordance with this section.

(4) Subsection (5) of this section shall apply in any case where, in relation to a group of companies (such group being referred to in this subsection ... and subsection (5) as a specified group) ...

(a) The same persons held at the end of that income year the whole of the paid-up capital in the same proportions in every company included in the specified group ...

(5) Where subsection (4) of this section applies to any specified group and to any income year.

Any loss ... may, if that company so elects by notice ... be deducted from the assessable income derived in that income year by such other company or companies included in the specified group as is or are nominated by that company ...

(7) Where:

(a) Any company makes a payment to another company under an agreement providing for the paying company to bear or share in losses or a particular loss of the payee company (being losses or a loss which are deductible under this Act); and ...

(b) Both companies are companies which are included in the same group of companies for the income year corresponding with the income year in respect of which the payment is made ...

the payment shall be deemed to be assessable income derived by the payee company on the last day of the accounting period in respect of which it is made, and to be deductible by the paying company as if it were expenditure necessarily incurred in the production of assessable income on that day.