The Personal Tax Planning Review

MOODIE v INLAND REVENUE COMMISSIONERS

Robert Venables QC[1]

The decision of the House of Lords, given on 11th February, in *Moodie v Inland Revenue Commissioners*[2] and a related appeal was the last step in a tax avoidance scheme which had begun more than two decades previously. The scheme had already been to the House of Lords once in *IRC v Plummer*.[3] Their Lordships' judgments are instructive as showing their latest thinking on the principles in *W.T. Ramsay Limited v IRC*[4] and *Furniss v Dawson*.[5]

The basic scheme was very simple. A taxpayer accepted an obligation to pay an annuity in return for a capital sum. The capital sum, being capital, was not liable to income tax. As it was not a sum derived from an asset - quite the contrary: it was derived from undertaking an obligation - it was not liable to capital gains tax either. Thus, it was entirely tax free. Yet payments of the annuity were in principle deductible in computing the total income of the taxpayer for income tax purposes. A test case was taken to the House of Lords by a Mr Plummer. In *IRC v Plummer* in 1979 their Lordships decided that the scheme worked.

The scheme in its basic form was stopped by what was originally Finance Act 1977 s.48 and is now Taxes Act 1988 s.125. The principle underlying the scheme, however, has never been legislated against and can still, in an appropriate case, enable large tax savings to be made.

The scheme as implemented involved the setting up of HOVAS, a charitable company incorporated for the purposes of the scheme. The taxpayer agreed to make to HOVAS five annual payments of a fixed amount subject to deduction of standard rate (now basic rate) income tax. In return, HOVAS paid a capital sum

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[2] [1993] STC 188.

[3] [1979] STC 793.

[4] [1981] STC 174.

[5] [1984] STC 153.

to the taxpayer. If that had been all, it is apprehended that the scheme would have succeeded as far as Mr Moodie was concerned. It is clear, however, from the reports of *Moodie* that the scheme involved a great deal more than the sale of an annuity for a cash sum. Lord Templeman, who delivered the only reasoned judgment in which the other Lordships concurred, was at pains to point out that all the money went round in circles. HOVAS borrowed the capital sum from the bank and paid it to Mr Moodie. Mr Moodie bought promissory notes which he deposited with HOVAS by way of security. The promissory notes were bought from a company in the same group as the bankers. This company passed on the consideration money to a third company in the group which lent it to HOVAS. HOVAS was then in turn able to repay its bankers.

Their Lordships had no difficulty in deciding that "With the benefit of the hindsight afforded by the speech of this House in *W.T. Ramsay Limited v IRC* ... it is now plain that Mr Moodie did not pay an annuity within the meaning of the taxing statute because the steps taken under the plan were self-cancelling."[6]

Now it is quite clear that if the matter had been *res integra*, the courts would have had no problem in deciding that this scheme was caught by the *Ramsay* principle and that Mr Moodie did not obtain his tax deduction. The only difficulty arose from the decision in *Plummer*. Normally, courts lower than the House of Lords are bound by a prior decision in the House of Lords and even the House of Lords itself only rarely departs from its previous decision. Were, therefore, at least courts up to and including the Court of Appeal bound by *Plummer* and should not the House of Lords hesitate not to follow it?

To my mind, the answer seemed obvious. As an academic, I never ceased to drum into my students what I had always perceived to be one of the fundamental principles of English law, resulting from our adversarial system, namely that no judicial decision is authority for a proposition which was not argued before it. That is why it is as important to look at the arguments in a case as it is at the judgments themselves. To me, it was abundantly plain that the applicability of the *Ramsay* principle not having been argued in *Plummer*, the decision in *Plummer* itself was no obstacle to the Revenue succeeding in *Moodie*. The Revenue did not seek to controvert any of the principles established by their Lordships in *Plummer*. There was no question of overruling it.

My approach was clearly too facile. For the Court of Appeal took a contrary view. They thought they were bound by the decision in *Plummer*. The House of Lords could and should have found for the Crown on this fundamental principle. Unfortunately, Lord Templeman did not express himself so clearly as he might.

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[6] Their Lordships do not tell us how they dealt with the question of the possibility of the premature death of Mr. Moodie. The annuity was four years or his life, if shorter. Had he died within the period, he would have made a profit on the transaction, so that it would have had very real commercial effects.

He has been consequently misunderstood. I find myself, therefore, coming, somewhat surprisingly, to his defence. In my view, he reached the right answer for the right reason, albeit somewhat imperfectly expressed.

He said, at page 194c:

> "If *Plummer* had been decided after *Ramsay*, the Crown would have succeeded, though not on any of the grounds advanced in *Plummer*. The present appeals are heard after *Ramsay* and this House is bound to give effect to the principle of *Ramsay*. I do not consider it is necessary to invoke the *Practice Statement (Judicial Precedent)* ... which allows the House "to depart from a previous decision when it appears right to do so". The result in *Plummer* (which is a decision of this House) is inconsistent with the latter decision in *Ramsay* (which is also a decision of the House). Faced with conflicting decisions, the courts are entitled and bound to follow *Ramsay* because in *Plummer* this House was never asked to consider the effect of a self-cancelling scheme and because the *Ramsay* principle restores justice between individual taxpayers and the general body of taxpayers."

With respect, it was not simply that the House of Lords was faced with two inconsistent decisions. If they were, they would surely have had the right to choose between them. There would be no question of their being automatically bound to follow one of those decisions. What was crucial in *Moodie* was an argument which was not advanced in *Plummer* but was advanced in *Ramsay* and was clearly a "clincher" in *Moodie* and would equally have been a "clincher" in *Plummer*. *Plummer* can be no authority that the argument was of no relevance if the argument had not been adduced in that case. No doubt it is very probable that this was what Lord Templeman was trying to say, albeit in a somewhat inarticulate fashion. Unfortunately, the manner in which he has expressed himself has given rise to much, largely unjustified, criticism.

Counsel for the taxpayer before the Court of Appeal were Andrew Thornhill QC and Kevin Prosser. They secured victory for the taxpayer in that Court. For some reason, Messrs Berwin Leighton, solicitors for the taxpayers, decided to bring in Michael Burton QC to lead, as it were, Andrew Thornhill QC in the House of Lords. On the face of it, this looks a very curious step. While Michael Burton QC is to my knowledge[7] a very able lawyer, he has no experience in taxation matters. Whether the result would have been any different if he had not appeared for the taxpayer in the House of Lords, I very much doubt. My own view is that the case was a virtually impossible one to win, at least in the House of Lords, and that Andrew Thornhill QC and Kevin Prosser did extremely well indeed to secure a victory in the Court of Appeal and, having regard to the terms

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[7] I have known him since undergraduate days.

upon which leave to the House of Lords was granted, payment by the Revenue to their client of his costs in the High Court and the Court of Appeal, leaving the Revenue to pay their own costs at all stages. It says much for the natural modesty of Andrew Thornhill QC that he did not object - as many of us might - to being led by a barrister with virtually no knowledge of or experience in the tax field.

What is the status of *Plummer* after *Moodie*? Clearly, *Plummer* has not been overruled. Unless one finds oneself in a *Ramsay* situation - basically, a self-cancelling series of transactions - or within the express terms of Taxes Act 1988 s.125, then *Plummer* is still alive and well and there are all sorts of situations where it can be used in personal - as well as in corporate - tax planning. It will be extremely useful wherever one is paid a capital sum as compensation for undertaking an obligation to make a series of income payments, which income payments are deductible in computing one's taxable profits.