THE *RAMSAY* DOCTRINE AFTER *McGUCKIAN*

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1 The Importance of the Decision

The House of Lords decision in *Commissioners of Inland Revenue v McGuckian* [1997] 1 WLR (12th June 1987), allowing the appeal of the Revenue from the decision of the Court of Appeal of Northern Ireland, is on one view the most significant Revenue victory yet in the development of the *Ramsay* doctrine. The House of Lords may well be about to shake off the limitations it imposed on the doctrine in *Furniss v Dawson* and which it so decisively re-asserted in *Craven v White*. The new decision will at the very least be treated by the Revenue as an invitation to have a go and cry *"Ramsay"* in many a virgin territory, just as they did between *Furniss v Dawson* and *Craven v White*, in the hope that the courts will extend the doctrine even further or that, the vast majority of taxpayers will cave in when presented with uncertainty as to the law. As is so often the case, taxpayers who are able to pay for quality advice will have the best chance of steering clear of the doctrine, whereas many who have entered into relatively unsophisticated and seemingly acceptable tax planning will find themselves under threat.

The decision is also important for the interpretation of the statutory provisions aimed at tax avoidance by individuals by the transfer of assets abroad. I discussed

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this aspect in 'Transfers of Assets Abroad After *McGuckian*'[2] in *The Offshore Taxation Review*.[3]

Although the central dispute concerned the year 1979/80, when Taxes Act 1970 was in force, I shall refer in this article to the provisions of Taxes Act 1988, which has consolidated the 1970 Act. Nothing in the decision is affected by the amendments since 1979.

2 The Facts

Mr McGuckian and his wife were domiciled and resident in the United Kingdom at all material times. In the early 1970s they owned equally the share capital of Ballinamore Textiles Ltd, which was incorporated and resident in the Republic of Ireland. By November 1979, the shares were held, as a result of gratuitous dispositions by them, by Shurltrust Ltd, a Guernsey resident trustee on trusts under which they were both beneficiaries and the income was payable to Mrs McGuckian. Ballinamore had income available for distribution by way of dividend amounting to £400,055. On 23rd November 1979, the trustee assigned to Mallardchoice Ltd for £396,054 the right to any dividend payable by Ballinamore in 1979. On 27th November, Ballinamore declared a dividend of £400,055 on the shares held by the trustee. Ballinamore gave a cheque for that amount to a Dublin solicitor for Mallardchoice. The solicitor paid the cheque into his client account out of which he then paid 99% of the sum, i.e. £396,054, to Shurltrust. The solicitor than paid the balance of 1%, less his fee, to Mallardchoice. The only way in which Mallardchoice could fund the purchase price was out of the dividend.

3 The Dispute

The whole point of the strategy was to ensure that what the trustees received was capital and therefore outside the scope of what is now Taxes Act 1988 section 739. Prima facie, this flowed from the decision of the Court of Appeal in *IRC v Paget* (1938) 21 TC 677. Unfortunately, the guiding mind behind the scheme appears

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2 The starting point for this article was another article written by me immediately after the speeches were handed down and published in *Taxation*, 18th June 1997. Transfers of assets abroad were considered in outline only in that article. My thinking as to the implications of the decision has naturally developed further in the interval between the two articles so that this article represents my more considered view.

3 Volume 7, 1997, Issue 2 at page 69. Aspects of the decision concerned with the capital/income distinction were discussed in the earlier version of this article which appeared in *Taxation* 18th June 1997.

to have overlooked that the strategy had been blocked by legislation as early as 1938, now consolidated as Taxes Act 1988 section 730! The Revenue assessed the taxpayer under what is now Taxes Act 1988 Part XVIII Chapter III (Tax Avoidance - transfers of assets abroad) but not under what is now section 730. The taxpayer's technical argument, which was conceded to have no ethical merit, amounted to this: because he should have been assessed under section 730, he could not be assessed under section 739 and it was now too late to assess him under section 730.

4 The "Prejudice"

The House of Lords took a dim view of the conduct of the solicitor. As Lord Browne-Wilkinson said: "There was prolonged correspondence between [the Revenue] and [the solicitor] who took every step to obfuscate what had happened and obstruct the Revenue in discovering the true facts ... At the date of the assessment [two weeks before the expiry of the normal six-year period] the Revenue had not discovered the existence of the settlement." He referred elsewhere to "the dubious stalling tactics" adopted by the English solicitor acting for the taxpayer.

The case was decided *in furore*, or at least in moral indignation at the repugnant thought that a taxpayer should escape a charge to tax simply because he was not assessed under the right section and the only reason he was not so assessed was that he had successfully concealed the true facts from the Revenue until the expiration of a limitation period. In an ideal world, this consideration would not have influenced the result. Either the taxpayer was entitled to act as he did and to escape an assessment to tax by the Fabian tactics of himself or of his advisers or he was not. If he was, then the law is deficient and needs amending. If he was not, then the appropriate steps should have been taken. Depending on the circumstances - and I stress that I am speaking purely theoretically and am not in a position to comment on the facts of this case - this could have involved his being assessed out of time, and/or being liable to penalties or even, in a serious case, of being indicted for conspiracy to cheat the Revenue. This is not an ideal world and their Lordships succumbed to the temptation to spike the taxpayer's guns at this stage rather than let him live to fight another battle, even one he was perhaps destined to lose. The price paid was arguably the making of some bad law, not least on Taxes Act 1988 section 739.

5 What was the Position in Private Law?

One unsatisfactory feature of the speeches is that they contain no analysis of the underlying private law, particularly trust law. The action of the trustees was, as a matter of trust law, extremely peculiar. The question which immediately sprang to my mind was: "What power did the trustees have to sell a dividend to which Mrs McGuckian would be absolutely entitled once it were declared?" Unless the terms of the settlement were extremely unusual or there were some other relevant factor which does not appear from their Lordships' speeches, the sale was *ultra vires* the trustees, the purchaser must assuredly have had constructive, if not actual notice, that it was and thus Mrs McGuckian would have remained the sole beneficial owner of the dividend. This would in principle have been a complete defence to an assessment under Schedule D Case VI under section 739, although it would not have prevented a simple assessment under Schedule D Case V. *Ramsay* would have been irrelevant as the steps adopted to effect the tax planning would have been ineffective as a matter of private law and there would have been nothing to counteract.

Even if the trustees did *prima facie* have power to enter into this type of transaction, it would still have been arguable that effecting it was a breach of their duty to keep a balance between those interested in income and those interested in capital, and thus the proceeds of sale of the right to the dividend belonged to Mrs McGuckian, the improper conversion being disregarded. This is not a matter of direct authority but is in my view the conclusion which follows from the application of certain basic principles of Equity, subject to there being nothing unusual in the trust documentation. Again, there would be no scope for *Ramsay* to apply.

The argument appears to have proceeded on the basis that the trustees did have power to effect the transaction. It also seems to have proceeded on the basis that the proceeds of sale did not in reality belong to Mrs McGuckian but were trust capital. The significance of these points will appear from the discussion below.[4]

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4 It should be noted that if in this case Mrs McGuckian, rather than the trustee, had sold the right to the dividend in advance, she could not have been caught by section 730, because she was not the "owner" of the securities. There is still the possibility of a beneficiary under a trust reaping a tax-free capital sum in such a case. Of course, section 730 is not the only anti-avoidance provision which needs to be considered, as does *McGuckian* itself on the possible application of *Ramsay*.

6 A Significant Development in the *Ramsay* Doctrine?

6.1 The Actual Decision

The transaction which was "collapsed" was the simple sale of the right to a dividend for a capital sum before it was declared. It was held that the sale of the dividend was to be largely ignored. The Revenue's argument, which was accepted, was that, applying the *Ramsay* principle, the sale of the right to the dividend fell to be disregarded for tax purposes on the grounds that it was an artificial transaction inserted for the sole purpose of gaining a tax advantage and that the reality of the transaction was the payment of a dividend by Ballinamore to the trustee, which received it as income. One might have thought that, given that the taxpayer could choose either to keep his right and himself collect the dividend, as income, or sell the right in advance and convert it into capital, then the case was governed by the residual principle of the *Duke of Westminster* case under which every man is entitled if he can to order his affairs so that tax under a tax statute is less than it otherwise would be. What is not entirely clear is whether their Lordships felt themselves able to ignore the sale only because it was clear from the outset that the purchaser would use 99% of the dividend to pay the price for the right to it, so that what the vendor received was the very same money paid out as a dividend by the company.

6.2 The Restrained View

The different approaches of their Lordships is striking. Lord Browne-Wilkinson stated that "nothing in this case turns on the exact scope of the *Ramsay* principle" and regarded the decision as falling "squarely within the classic requirements for the application of the principle as stated by Lord Brightman in *Furniss v Dawson*". On his approach, there is at least no abandonment of the limitations introduced by *Furniss v Dawson*. Instead, he is simply refining, and, in my view, extending, the law on what constitutes a transaction and what can be regarded as inserted steps, without denying that inserted steps are needed. He is simply being disingenuous when he states that nothing in this case turned on the exact scope of the *Ramsay* principle. The difference of opinion between himself and the majority in the Court of Appeal turned precisely on the exact scope of the *Ramsay* principle.

Lord Clyde applied *Ramsay* in just the same way.

6.3 The Wilder View

Lord Steyn, by contrast, ominously rejected as a "false foundation" counsel for the taxpayer's plea that the scope of the underlying principle in *Ramsay* should not be extended beyond the existing decisions. He regarded tax law as having been "by and large left behind as some island of literal interpretation" while over the last thirty years there had generally been a shift from a literalist to a purposive construction of statutes. In asserting in *Ramsay* the power to examine the substance of a composite transaction "the House of Lords was simply rejecting formalism in fiscal matter and choosing a more realistic legal analysis". He thus concluded, somewhat alarmingly, that "it is wrong to regard the decisions of the House of Lords since *Ramsay* as necessarily marking the limit of the law on tax avoidance schemes". The actual *ratio* of his decision, however, is undistinguishable from Lord Browne-Wilkinson's: the assignment was not "the whole substance of the transaction", as the majority of the Court of Appeal had held, but merely "a means to an end", a step taken purely for tax avoidance purposes.

Lord Cooke of Thorndon associated himself with all that Lord Steyn said about statutory interpretation, i.e. the *Ramsay* principle. The *ratio* of his decision, too, was identical to that of Lord Browne-Wilkinson and of Lord Steyn. Even more ominously, while accepting that the present case fell within the limitations of the doctrine expressed by Lord Brightman in *Furniss v Dawson*, he added "but it may well be as well to add that, if the ultimate question is always the true bearing of a particular taxing provision on a particular set of facts, the limitations cannot be universal" - by which he means, in plain language, that the limitations are not limitations at all! He adds: "I suspect that advisers of those bent on tax avoidance .... do not always pay sufficient heed to the theme in the speeches in *Furniss* ... to the effect that the journey's end may not yet have been found." No doubt that ii because they naively thought that the House of Lords in *Craven v White* had definitively stated that the journey's end had been found.

Of course, the notion that *Ramsay* is simply a rule of statutory interpretation fools no one. Nor is it seriously intended to. By treating the *Ramsay* doctrine as a general rule of statutory interpretation, rather than as a judge-made rule applicable to tax avoidance, the judges are on the one hand defending their actions as constitutional and on the other giving themselves almost carte blanche to re-write the tax code, under the guise of interpretation, whenever they consider that unacceptable tax avoidance is involved.

6.4 The Casting Vote

Lord Lloyd of Berwick agreed that he would allow the appeals "for the reasons which [the other four Law Lords] give". It would appear that he is not agreeing with the wider dicta of Lords Steyn and Cooke, as it was not their reason for allowing the appeals, and Lord Browne-Wilkinson and Lord Clyde confined themselves to a narrower *ratio*. Hence, for the moment, one cannot say that the wider approach has commanded a majority in the House of Lords.

6.5 The Future?

What is so alarming is the apparent unpredictability of the House of Lords reaction to tax planning. The low water-mark of the doctrine was reached in *Fitzwilliam* in 1993. In that case, in implementation of a preordained tax-avoidance scheme, a mother gifted a large sum of money to her daughter and the daughter used it to pay a grossly inflated price in purchasing a virtually worthless interest in possession from the mother. All their Lordships, save Lord Templeman, refused to re-characterise the transactions as a simple gift of the interest in possession from the mother to the daughter, ignoring the money which went round in its predestined circle. One wondered what was left of *Furniss v Dawson*. I went on record as saying that the decision was too good to be true. It was. I understand from Leading Counsel for the Revenue that the *Fitzwilliam* decision played very little part in the argument in *McGuckian*. In fairness to Leading Counsel for the taxpayer, I doubt it would have made much difference if it had.

Lords Steyn and Cooke may well turn out to be *enfants terribles* who will terrorise tax planners (and their clients' counsel!) for many a year. Now that the ground rules are once again shifting, anything is possible. Now that *Lady Ingram*, is going to the Lords, that could well be the next opportunity for the Revenue to seek to extend the judicial doctrine, as their *Ramsay* argument in that case does not depend on inserted steps or self-cancelling transactions.

7 An Unexplored Difficulty

7.1 The Position if a Dividend had been Received Directly by the Trustees

It was crucial to the success of the Revenue that they should show not only that there was income which was assessable on Mr McGuckian, but that it was assessable under section 739. For it to be assessable under section 739, it must have arisen to a person resident or domiciled out of the United Kingdom. Now if the trustees had done nothing, the dividend would have been received as such and would have been the income of Mrs McGuckian, who was not resident or domiciled outside of the United Kingdom. Hence section 739 could not have applied.

It is true that the trustees might well have received the dividend in the first instance, in which case they would (section 739 apart) have been taxable under Schedule D Case V in a representative capacity. Nevertheless, the income would still have been that of Mrs McGuckian and not that of the trustees. That was established by the House of Lords in 1920 in one of the key cases on the income taxation of trusts, *Williams v Singer* 7 TC 387. The case is often misunderstood and regarded as turning on the fact that the trustees had mandated the payment of the income directly to the tenant for life, but a more careful reading shows that this was not the *ratio*. It is also true that in *Vestey v Inland Revenue Commissioners* [1977] STC 414, in the Chancery Division, Walton J rejected the taxpayers' argument that "trustees" could not be "persons" within section 739. Rightly. Where there is no beneficiary entitled to the income as it arises, the trustees are themselves taxable definitively and not in a merely representative capacity, at least in the first instance. Such was the situation in *Vestey*, where the trusts were discretionary.

7.2 The Author's Argument

I would have put the following argument had I represented the taxpayer:

> *Ramsay* apart, there was no income;[5] hence section 739 could not operate.
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> The only way in which section 739 could be brought into play would have been if the income was deemed to arise to the trustees yet not to belong beneficially to Mrs McGuckian.
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> Yet the *Ramsay* doctrine could not operate so as to produce that result. As was established by the House of Lords in *Fitzwilliam*[6] it must be intellectually possible realistically to treat the steps involved as constituting a single and indivisible whole in which one or more of them was simply an element without independent effect. The consequence is that while you can "re-characterise" the transaction(s) for tax purposes, you must be able to do so consistently with reality.
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> In this case, their Lordships identified the "real transaction" as "the payment of a dividend to the shareholder [the trustee] which received such dividend as income".[7] Yet if the payment was income of the trustee, then it belonged to Mrs McGuckian beneficially, so that section 739 could not apply.

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5 Pace Lords Cooke and Steyn.

6 [1993] STC 502.

7 Per Lord Browne-Wilkinson.

7.3 The Speeches

Unfortunately, the argument for the taxpayer appears to have been rather different, namely that Taxes Act 1988 section 730 prevented section 739 from applying.[8] Four of their Lordships decided that *Ramsay* operated so as to prevent section 730 applying,[9] whereas Lord Clyde opined that section 739 could apply even where another anti-avoidance provision could also apply.

None of their Lordships focused on the vital question: "How can *Ramsay* apply so as to deem the capital receipt not merely to be income but to be income of a different person?" Clearly, there is no question of applying *Ramsay* proper and holding that the transactions were to be regarded as self-cancelling, because the result was different, there was a change of beneficial ownership.[10] What of the rule in *Furniss v Dawson* that one can re-characterise a linear transaction into which steps are inserted? The difficulty here is that the only transaction was the sale of the right to the dividend, into which nothing was inserted. The sale was not re-characterised. It was (as to 99%) ignored.

So what we have, apparently, is a transaction which produced real consequences being for tax purposes both partly ignored and partly recognised. It is not just that the re-characterisation is for tax purposes only and not, say, for trust purposes. This is a decided innovation and contrary to the tenor of previous authority.

8 Other Implications for the *Ramsay* Doctrine

8.1 The "Part of Another Scheme" Argument Counsel for the taxpayer argued that the transaction was part of a larger, and different, tax scheme, designed in 1976 with a view to avoiding an anticipated wealth tax and that a preordained series of transactions to avoid that wealth tax had not been demonstrated. Lord Browne-Wilkinson held, rightly, that the sale of the future right to the dividend was a discrete transaction. Lord Cooke likewise expressly rejected this argument, as did, by implication, the other members of the committee.

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8 This argument is discussed more fully in the companion article in *The Offshore Taxation Review*, Volume 7, Issue 2, at page 69.

9 This is discussed at 8.3 below.

10 The argument might, of course, have been turned on its head. It might have been said that the fact that the proceeds of sale of the right to the dividend did not in fact belong to Mrs McGuckian prevented the transaction from being re-characterised as it was.

8.2 What if the Tax Avoidance would not have Worked?

It is implicit in the decision that steps inserted for a tax avoidance purpose can be disregarded even if they were misconceived because the tax avoidance would not have worked.

8.3 Does a Statutory Anti-avoidance Provision Prevent *Ramsay* Applying?

Before the decision, is was a moot point whether a "closed field" rule operated, so that *Ramsay* could apply even where there was a statutory anti-avoidance provision in the same area. Judicial decisions in cases where the anti-avoidance provision actually yields the same result as *Ramsay* will be rare, as it will normally be academic by which means the taxpayer is caught. *McGuckian* was such a case. Their Lordships decided that in such a case not only can *Ramsay* still apply but it can actually prevent the anti-avoidance provision from biting. If section 730 had bitten, then subject to a second argument, it was supposed that section 730(1)(b) deemed is to be the income of Mrs McGuckian (and thus in turn that of Mr McGuckian), in which case section 730(1)(c) expressly states that it should not be deemed to be the income of any other person, in particular, any person domiciled or resident out of the United Kingdom.

Their Lordships said that in this case, because *Ramsay* applied, the sale of the right to the dividend fell to be disregarded; hence section 730 did not apply. The result was slightly beneficial to the taxpayer. If a person sells a right to a dividend, he is normally taxable, under section 730, as if he had not done so, i.e. he is taxable on the entire amount of the dividend as if it were his. Yet their Lordships rejected the Revenue contention that Mr McGuckian was taxable on the entire amount of the dividend, rather than the 99% equivalent in value to the proceeds of sale of the right to it. While it is not immediately obvious how they arrived at this result - it is difficult to see how it can be consistent with the statement that *Ramsay* required the sale of the dividend to be disregarded - it does mean that Mr McGuckian at least obtained a tax deduction for part of the costs of implementing the scheme!

The decision that *Ramsay* can actually prevent a charge to tax under an anti-avoidance provision is a not unwelcome precedent. Is remains to be seen how far is will be followed when it is to the taxpayer's advantage!

8.4 What is the Status of *Fitzwilliam*?

In *Fitzwilliam*, the House of Lords reasoned (arguably obiter) that because the inheritance tax planning produced income tax consequences, the transactions could not be re-characterised for inheritance tax purposes. I have argued in 'Judicial

Anti-Voidance Doctrines after *Countess Fitzwilliam*' in *The Personal Tax Planning Review* Volume 5, Issue 3, at page 165, that on the facts of the case this was a most unconvincing argument and that, as a matter of principle, there is no reason why re-characterisation for the purposes of one tax should involve re-characterisation for the purposes of all taxes. One cannot tell from the speeches in *McGuckian* whether or not it was argued by counsel for the taxpayer that the fact that the dividend was in reality received by Mallardchoice, so as to form part of its franked investment income for corporation purposes, prevented the transactions from being re-characterised so as to deem it to have been received by the trustees. If it was, it was simply ignored. Instead, their Lordships' reasoning impliedly proceeded on the premise that one re-characterises first and does not then reconsider the matter provided the re-characterisation solves the problem. In *McGuckian*, it clearly did, as it involved an amount of the dividend equal to the sale proceeds being deemed to be that of Mrs McGuckian and hence not that of Mallardchoice. One could, of course, attempt to reconcile the two cases on the grounds that the *ratio* of *Fitzwilliam* is that it is not possible to re-characterise for the purpose of one tax (inheritance tax) if the re-characterisation produces results inconsistent with the actual consequences of another tax (income tax). The risk is that courts in future will regard *Fitzwilliam* as confined to its own special facts, i.e. estate tax planning by countesses, and as having no application to income tax planning by entrepreneurs.

9 What is Left of the *Paget* Principle after *McGuckian*?

9.1 What was left before *McGuckian*?

The problem the Revenue faced arose principally because of the decision of the Court of Appeal in *IRC v Paget* (1938) 21 TC 677 that the proceeds of sale of "coupons" from (i.e. the right to be paid interest on) foreign bonds were capital and not income. The *Paget* principle has been eroded by statute. In 1938 there was enacted the ancestor of Taxes Act 1988 section 730, which counteracts *Paget*: where the owner of any "securities" sells or transfers the right to receive any interest payable in respect of the securities without selling or transferring the securities, then the interest is deemed to be the income of the owner. Many other provisions can now apply where a right to investment income is sold together with the underlying asset, not least of all the corporate bond provisions contained in Finance Act 1996. *McGuckian* apart, there were still residual areas where the *Paget* principle could apply and where a taxpayer with a good guide could manage to steer clear of the anti-avoidance provisions. Where, for example, I, being an individual, am entitled to interest on a private loan, I can sell my entire rights, i.e. to be paid both principal and interest, and the sale proceeds are capital.

9.2 Post *McGuckian*

When, if at all, will *McGuckian* counteract this? It would be foolhardy to rely on distinguishing *McGuckian* on the grounds that in that case there was a sale merely of the right to income. If the sale is arranged on terms such that the buyer can only fund the purchase price out of the income and/or proceeds of disposal of the right to the debt, then the risk of *McGuckian* being held to apply must be very high indeed. The risk is perhaps rather lower if the buyer has to borrow to buy and can repay the loan only out of the proceeds of sale.

If the sale is for a predominantly commercial reason there should be no question of *McGuckian* applying. For example, if I sell my rights qua creditor to a factor because the debtor is unable to pay the interest for the time being and I am myself in need of money.

But what if the sale is for tax avoidance reasons yet the buyer funds the purchase price out of its own funds and what I receive is not, even indirectly, the interest paid by the debtor? My own instinct is that this is still safe, but the contrary is certainly not unarguable. The chances of *Ramsay* applying are in my view much less if the asset will produce more income in future and the buyer does not immediately dispose of it and/or if the income is only accruing when the sale is made. In either of these cases, time scales could well be important.

What of the very common case of the factoring of debts by a trader? My own instinct is very much that *Ramsay* would not apply, as the proceeds of disposal would themselves be receipts entering into the calculation of taxable income. While for that reason *Ramsay* would not usually confer any advantage on the Revenue, yet there might be cases where it would be worth the Revenue's while to try to argue that it did apply. For example, if the debts were factored in one year when the rate of tax was low but collected by the assignee in the next when it was higher.

10 Conclusion

McGuckian is arguably the most important tax case since *Craven v White*. Even if the wider *dicta* are not followed in future, it may well be the next century before the law can be regarded as anything like settled. In the meantime, tax advisers will have to exhibit even more care and circumspection than usual. The role of the tax lawyer will be very important, given that the interpretation of judge-made law is essentially a matter for lawyers.