The Interpretation of Taxing Statutes: The English Perspective

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Revenue law is entirely a creature of statute. The maxim that there is "no equity in tax" is embodied in the Bill of Rights 1689 which provided for "no taxation without legislation." This principle was of major political importance in 1689 because prior to the English Civil War 1642-49, Charles I had attempted to raise funds without the aid of Parliament, by inter alia, levying a window tax\(^1\) and imposing the payment of ship money\(^2\) nationwide. The authors of the Bill of Rights were keen to ensure that the monarch would be unable to exercise such absolute power in the future. This was achieved by the recognition of the supremacy and sovereignty of Parliament in such, and other, matters.

In terms of revenue law, the principle of "no taxation without representation" means that there is no such thing as a common law tax. A subject's obligation to pay tax is derived from the words of the statute alone. In this regard, therefore, taxing statutes are viewed as a special class of statutes and the rules of statutory interpretation have a special importance in relation to them. Furthermore, the rules have been modified to some extent, with the result that there has been an overemphasis on the use of the literal rule.

One of the earliest judicial expositions of the maxim that there is "no equity in tax" can be found in the judgment of Lord Cairns in *Partington v. Attorney-General*,\(^3\) where he said:

As I understand the principle of our fiscal legislation, it is this: if the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be.\(^4\)

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\(^1\) "Window tax" was a tax imposed on the number of windows in a house.

\(^2\) "Ship money" had traditionally been levied on coastal towns for the purpose of paying for the navy. The extension of the tax nationwide caused much unrest because the tax was imposed on many who had never seen the sea.

\(^3\) (1869) LR 4 H L 100.

\(^4\) *Id.* at p 122.
This extract illustrates that the principle can operate both in favor of or against the taxpayer. Over the years, the principle has been applied with extreme rigidity, requiring strict adherence to the words rather than the sense. It has been especially valuable, therefore, to the tax avoider. This can be illustrated by *IRC v. Duke of Westminster*, one of the earliest and most authoritative cases on tax avoidance. The Duke of Westminster, desiring to reduce his liability to surtax, decided to pay his servants by way of a deed of covenant rather than by paying them wages directly. By doing this, the payment under the covenant operated as a charge on the Duke's income, thereby reducing his taxable income. The Inland Revenue brought a test case in respect of the payments so made to the Duke's gardener. The case went to the House of Lords, where Lord Tomlin said:

> Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of the Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax.

The Duke of Westminster, therefore, was successful because the House of Lords preferred the form of the matter over the substance.

The basic principle of there being no equity in tax is supplemented by others. Firstly, it must be clear from the words of the statute that a tax is imposed. This is related to the main principle and can be illustrated by the comments of Lord Halsbury in *Tenant v. Smith*, where he said:

> "[I]n a taxing Act it is impossible, I believe, to assume any intention, any governing purpose in the Act, to do more than take such tax as the statute imposes."

This principle again emphasizes the overriding importance of the literal rule in the interpretation of taxing statutes, as does the rule that the words must be given their natural meaning. This latter rule is adhered to even when the result is anomalous.

Difficulties can occur where there are ambiguities in the statute. One issue here is whether or not, in such cases, the courts may consider other legislation as a

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5 [1936] AC 1.
6 *Id.* at 19.
7 [1892] AC 150.
8 *Id.* at p. 154.
9 See, for example, *IRC v. Hinchy* [1960] AC 748, where the relevant provision contained a penalty for the underpayment of tax. It provided that if there was an underpayment, the taxpayer had to pay a penalty of three times the tax due. It was meant to read three times the amount underpaid, but the House of Lords construed it literally.
means of resolving the problem, that is, can a particular Tax Act be viewed as part of a wider scheme? This issue has never been completely resolved but the courts have occasionally construed an Act as a whole, rather than merely the narrow part of it relevant to the issue at hand.¹⁰

Traditionally there was only one exception to the plain meaning rule and this was where the taxpayer was at risk of having imposed upon him a liability so far-fetched and so fantastic that the suggestion that that was what Parliament intended could not be entertained. This is used in conjunction with the minor rule that the taxpayer has the benefit of the doubt. In this context, Lord Reid said:

"[I]n order to avoid imputing to Parliament an intention to produce an unreasonable result, we are entitled and indeed bound to discard the ordinary meaning of any provision and adopt some other possible meaning which will avoid that result."¹¹

In this case the House of Lords relied upon the underlying premise that Parliament intended a reasonable result. This can be said to be an example of the House of Lords legislating, which is rare in the case of taxing statutes. Alternatively, it can be argued that the House of Lords was merely applying all of the rules of statutory interpretation that are applicable to taxing statutes.

A further example can be found in Vestey v. IRC.¹² In this case, two interpretations of the relevant statutory provision were possible. One, by looking at the preamble and reading the section as a whole, would confine the application. The other was to give the section an extended meaning, so as to embrace all persons born or unborn, who in any way may benefit from assets transferred abroad by others. The House of Lords considered that the latter view was unreasonable and unanimously favored the narrower interpretation.

Vestey illustrates the extent to which reason and fairness may prevail. The legislation under consideration in that case was concerned solely with dispositions which had tax avoidance as their only or main object, and still the House of Lords found that the scheme in question fell outside of the statutory provisions.¹³

Thus it can be seen that the English courts have traditionally rigidly adhered to the literal rule when interpreting taxing statutes. The only exception is where the result produced by the literal rule is so unreasonable that the courts do not believe that that result would reflect the intention of Parliament. The cases already referred to indicate that even the House of Lords was unwilling to use that exception in cases

¹⁰ See especially IRC v WT Ramsay & Sons Ltd. [1982] AC 300 infra.
¹² [1979] 3 All ER 976.
¹³ The statute was changed after the Vestey decision, see Finance Act 1981, s. 45. A further example of the literal rule in a case involving a tax avoidance scheme can be found in IRC v Plummer [1979] 3 All ER 775.
of tax avoidance. In other words, the courts did not distinguish the motives of the taxpayer. They merely examined the facts of the case and then interpreted the legislation in accordance with the above principles. The result was not affected in any way by the fact that the taxpayer had deliberately created a particular set of circumstances as part of a tax avoidance scheme.

The first signs of a change in the judicial approach to the interpretation of taxing statutes can be found in the dissenting judgment of Eveleigh LJ in *Floor v. Davis*. This case involved a tax avoidance transaction whereby shares held by the taxpayer were sold to another company, FNW, newly incorporated for the purpose, in consideration for shares in FNW. FNW sold the shares to KDI for a consideration of £560,889. FNW then went through a series of operations whereby, making use of certain special provisions in its articles, it went into liquidation and distributed six-sevenths of this sum of £560,889 to a foreign company which, through the instrumentality of a rights issue, had acquired ordinary shares in FNW.

The Inland Revenue sought to assess the taxpayer to capital gains tax by reference to the proportion of the sum paid by KDI to FNW which corresponded to the shares that the taxpayer had originally transferred to FNW. Had the taxpayer sold the shares directly for cash, the profit thereon would have been chargeable to capital gains tax. Capital gains tax is charged on the gain accruing on the disposal of assets. There is no statutory definition of "disposal" but it is clear that it includes all obvious transactions, for example, gift, sale, exchange (which would be two disposals).

The statute does provide, however, that where shares in one company are exchanged for shares in another, there is no disposal. It was for the purpose of taking advantage of this provision that the taxpayer had sold the shares to FNW rather than directly to KDI. The Inland Revenue contended that this should be treated as a direct sale to KDI, because, in effect, that was what had occurred. This argument found favor only with Eveleigh LJ in the Court of Appeal. He acknowledged that the only reason for the first sale to FNW was the avoidance of capital gains tax and further that there was no real possibility that the shares would not reach their final destination. In other words, the transactions were preordained. The taxpayer "controlled the destiny of the shares from beginning to end in pursuance of a continuing intention on their part that the shares should be transferred to KDI".

The question was whether the court should view each step in isolation or whether it should examine the transaction as a whole. The former approach would

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14 *Floor v. Davis (Inspector of Taxes) [1978] 2 All ER 1079.*
16 *Id.*
18 [1978] 2 All ER 1079 at 1088.
19 *Id.*
mean that the taxpayer would be successful and the latter that he would not. Eveleigh LJ alone considered that the latter view was the correct one. He continued that he did not think that this conclusion was in any way vitiated by *IRC v. Duke of Westminster.*

He emphasized that he was not seeking to say that the transfer to FNW was not a transfer. He said:

"The important feature of the present case is that the destiny of the shares was at all times under the control of the taxpayer who was arranging for them to be transferred to the American company. The transfer to FNW was but a step in that process."

The judgment of Eveleigh LJ did not affect the outcome of the case, since the rest of the Court of Appeal and the House of Lords found for the Inland Revenue on other grounds. The issue of viewing the transaction as a whole was not raised in the House of Lords, which forum, therefore, had no opportunity in which to comment on such an approach.

A few years later, however, the House of Lords did have the opportunity and were unanimous in their support of the reasoning employed by Eveleigh LJ in *Floor v. Davis.* The case was *WT Ramsay Ltd. v. IRC.* This involved another tax avoidance transaction. The taxpayers purchased a tax avoidance scheme. Once the purchase was complete, various steps were carried out, documents executed, payments made, according to a rapid timetable. The end result was that the taxpayer claimed an artificial capital gains tax loss against which he could offset real gains.

The question for the House of Lords was whether the scheme could be viewed as a whole. The main judgment, delivered by Lord Wilberforce, recognized that the scheme was a sham. He said:

"[A]lthough sums of money, sometimes considerable, are supposed to be involved in individual transactions, the taxpayer does not have to put his hand in his pocket."

The only genuine expense that the taxpayer incurred was the purchase of the scheme. But this fact alone did not mean that the transaction could automatically be viewed as a whole. To do so required the House of Lords to take a new approach to the interpretation of taxing statutes in general and to tax avoidance schemes in particular. The traditional approach, of acknowledging that there is no equity in tax and that...

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21 [1978] 2 All ER 1079 at 1089.
22 Sir John Pennycuick and Buckley LJ.
24 [1978] 2 All ER 1079.
26 Id. at 322.
27 Supra.
the taxpayer could organize his affairs as he wished in order to reduce to his liability to tax etc., would confine the House to an examination of each step of the transaction in isolation. Furthermore, if the House of Lords was to view the transaction as a whole, it was argued on behalf of the taxpayer that that would amount to legislating, which function ought properly be left to Parliament. In other words Parliament should lay down any general principles against tax avoidance and not the courts.

Lord Wilberforce said:

I have a full respect for the principles which have been stated but I do not consider that they should exclude the approach for which the Crown contends. That does not introduce a new principle: it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation. While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still. 28

He continued that capital gains tax "was created to operate in the real world, not that of make-belief." 29 In the instant case the taxpayers were seeking to utilize a capital gains tax loss which they had not in fact incurred. The transaction was a sham. The House of Lords therefore felt itself to be justified in viewing the transaction as a whole so that it could examine what really happened. By this mechanism it was able to arrive at a unanimous decision in favor of the Inland Revenue. 30

Although their Lordships stated that this approach was not at variance with the decision in IRC v. Duke of Westminster, 31 this case nonetheless did mark the beginning of the movement away from the traditional method of interpreting taxing statutes. Previously, each step would have been viewed in isolation and given its legal effect. Thus, if the first step was within the law and permitted by the relevant Tax Act, the court would allow it and then move on to consider the next step and so on. In other words the court would prefer form over substance. The justification for the departure from the traditional analysis rests on the fact that the transaction was a sham and that it was a composite transaction. Once the scheme was started, it was the intention of the taxpayer (whether contractual or not made no difference 32 ) that it should proceed through to the end. There was no intention that it should be arrested half-way. Indeed, such a cessation would have been particularly difficult to

28 [1982] AC 300 at 326.
29 Id.
30 In arriving at this decision, it is interesting to note that their Lordships were referred to several U.S. decisions in which the US courts had denied effect to schemes designed for the sole purpose of the avoidance of tax. In particular, Lord Wilberforce referred to Knetch v. United States 364 U.S. 361 (1960) and to the judgment of Judge Learned Hand (dissenting on the facts) in Gilbert v. Commissioner of Internal Revenue 248 F.2d 399, 411 (2d. Cir. 1957) where he had said "If, however, the taxpayer enters into a transaction that does not appreciably affect his beneficial interest except to reduce his tax, the law will disregard it,..."
32 [1982] AC 300 at 322, per Lord Wilberforce.
accomplish in Ramsay because there the scheme was a purchased one. Once the taxpayer had paid the purchase price, he had no further (active) part to play. The scheme continued to its conclusion.

Whilst the decision in Ramsay may be difficult to reconcile with the traditional analysis, it can be justified on the grounds, inter alia, that tax avoidance is as morally wrong as tax evasion. By the purchase of a tax avoidance scheme, the taxpayer in Ramsay was doing more than merely organizing his affairs so as to minimize his tax liability: he was creating an artificial capital gains tax loss. This is very different from IRC v. Duke of Westminster,33 where the Duke paid his servants via a deed of covenant rather than directly. Whatever method of payment he embarked upon, the Duke always intended to pay his servants and accepted the responsibility for doing so. If one method was more tax advantageous than another, he was free to use it and the courts would not interfere. In one sense the deed of covenant was a sham in that it disguised the payment of wages to his servants, but it was not a sham in the Ramsay sense. The deed was genuine and, had the Duke defaulted, his servants could have sued to enforce payment. Further, the Duke did have “to put his hand in his pocket” in order to make the payments. He merely did so in a tax efficient way. This is not at all analogous to the creation of the artificial capital gains tax loss that occurred in Ramsay.

Following the decision in Ramsay, the new approach to the interpretation of taxing statutes enunciated by Lord Wilberforce was adopted by the courts with respect to tax avoidance schemes. The House of Lords itself had the opportunity to underline the validity of such an approach in IRC v. Burmah Oil Co. Ltd.,34 another case involving an artificial tax avoidance scheme. In that case, Lord Diplock said:

“It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax-avoidance schemes to assume, that Ramsay’s case did not mark a significant change in the approach adopted by this House in its judicial role to a preordained series of transactions...”35

It appeared at that time, therefore, that the position was clear. The statutes would be interpreted literally and a man was still free to organize his affairs so as to minimize his liability to tax. He was not permitted, however, to enter into artificial transactions solely in order create artificial tax losses or advantages. In the latter case the courts would look to the substance of the transaction and not to the form. There were many who were unhappy about this dividing line, especially the tax accountants who had found the sale of such tax avoidance schemes to be very lucrative. Nonetheless, it was a line that could be recognized with reasonable accuracy and it was generally

33 [1936] AC 1.
35 Id. at 32.
accepted that there was a difference between the purely artificial tax avoidance scheme and the organization of one's own affairs such as had occurred in the *Duke of Westminster.* It is one thing to claim the benefit of a loss that was not genuine, but it is quite another to organize one's affairs in such a way as to take advantage of a relief under the Tax Acts.

This then remained the position until 1984 when the House of Lords heard the case of *Furniss v. Dawson.* This did not involve a tax avoidance scheme as had *Ramsay,* but rather a tax deferment scheme. Tax deferment schemes had traditionally been treated in the same manner and viewed in the same light as tax avoidance schemes. The House of Lords saw no reason to distinguish them here. The facts can be summarized as follows. The taxpayers held shares in a company which they wished to sell to Wood Bastow. Instead of doing so directly, they arranged first to exchange their shares for shares in an investment company, Greenjacket, incorporated in the Isle of Man (a tax haven). The transfer to Greenjacket took place on 16 December and a 20 December Greenjacket held a board meeting at which the transfer of the shares to Wood Bastow was effected. There were very full minutes of that meeting which showed that the whole process was planned and executed with faultless precision. The Inland Revenue sought to assess the taxpayers to capital gains tax on the sale of the shares to Wood Bastow by looking to the substance of the transaction rather than to the form. The form indicated that the taxpayers would not be liable to tax unless and until they disposed of the shares they now held in Greenjacket. Thus the taxpayers were not seeking to avoid their liability to tax but merely to postpone it within the rules applicable to capital gains tax. This is not the same situation as in *Ramsay* or *Burmah Oil* and indeed Lord Brightman acknowledged in *Furniss* that the scheme was "simple and honest". Additionally the schemes in *Ramsay* and *Burmah Oil* were circular or self-canceling whereas the scheme in *Furniss* was linear. Nonetheless, the House of Lords still found in favor of the Inland Revenue.

The reasoning behind this decision needs to be examined in detail because it

37 [1984] 1 AC 474.
38 There was no chargeable gain on the sale by Greenjacket to Wood Bastow because Greenjacket was an Isle of Man company and not, therefore, subject to capital gains tax. In any event as the shares were sold for the acquisition price there was no capital gain accruing to Greenjacket.
39 The advantage to the taxpayers was that they did not make a gain which was subject to capital gains tax. They could, however, benefit financially by taking a loan from Greenjacket of the proceeds of sale of the original shares. This could be a low or zero rate interest, indefinite loan, which had no tax consequences. Further, as the only shareholders in Greenjacket, the taxpayers themselves could determine when or if Greenjacket would be liquidated. If it was liquidated, or the taxpayers sold their shares in Greenjacket, capital gains tax would be payable at that time.
40 [1982] AC 300.
42 [1984] 1 AC 474 at 518.
43 [1982] AC 300.
45 [1984] 1 AC 474.
involved more than a mere application of the Ramsay principle: it was an extension of it. The main judgment was delivered by Lord Brightman who first reviewed the authorities from the Duke of Westminster\textsuperscript{46} to the judgments of Lord Wilberforce in Ramsay\textsuperscript{47} and Lord Diplock in Burmah Oil\textsuperscript{48}. He too acknowledged the judicial change in approach to the interpretation of taxing statutes in cases of tax avoidance that had been expounded by Lord Wilberforce.\textsuperscript{49}

In Furniss v. Dawson,\textsuperscript{50} the lower courts had all found in favor of the taxpayers, distinguishing it from Ramsay because it did not involve a wholly artificial tax avoidance scheme. At first instance\textsuperscript{51} Vinelott J had said that the Ramsay principle did not apply to the facts of Furniss and a transaction cannot be disregarded and treated fiscally as a nullity if it has "enduring legal consequences".\textsuperscript{52} This view was approved by the Court of Appeal\textsuperscript{53} in the leading judgment of Oliver LJ but it found disfavor in the House of Lords where Lord Brightman described it as "totally untenable."\textsuperscript{54} Lord Brightman continued:

It is difficult to escape the impression that the High Court and the Court of Appeal\textsuperscript{55} were determined at all costs to confine the Ramsay principle to the sort of self-canceling arrangement which existed in that case, and to resist what they conceived to be a deplorable inroad into the sacred principles of the Westminster case.\textsuperscript{56}

He concluded that the transfer of shares to Greenjacket had no commercial or business purpose apart from a tax advantage. As such that step could ineffectively be ignored and, following the Ramsay principle, the courts were free to examine the substance of the transaction, namely a sale of shares by the taxpayers to Wood Bastow - a transaction which was immediately taxable.

In Furniss v. Dawson,\textsuperscript{57} the House of Lords did not expressly overrule their earlier decision in IRC v. Duke of Westminster.\textsuperscript{58} It is arguable, however, that the effect of the decision did precisely that. Lord Brightman specifically approved\textsuperscript{59} the dictum of Lord Wilberforce in Ramsay where he had said:

To force the courts to adopt, in relation to closely integrated situations,
a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process... legislation cannot be required or even be desirable to enable the courts to arrive at a conclusion which corresponds with the parties’ own intentions.  

Thus the fact that the court accepted that each step in the transaction was genuine did not, per se, confine the court to the examination of each step in blinkers for the purpose of ascertaining the fiscal consequences. In the words of Lord Wilberforce "...viewed as a whole, a composite transaction may produce an effect which brings it within a fiscal provision." The result can only be achieved by looking to the substance of the transaction and not to the term, contrary to the dictum of Lord Tomlin in IRC v. Duke of Westminster. The decision in Furniss, therefore, is that where there is a composite transaction or a preordained series of transactions, where steps are inserted that have no business purpose other than the securing of a tax advantage (that is not to say no business effect) then the court is free to examine the transaction as a whole and to ignore the artificially inserted steps.

The other problem raised by the decision in Furniss, apart from the status of the decision in Duke of Westminster, is more serious. It is the extent to which the motive of the taxpayer is relevant. In cases such as Ramsay and Burmah Oil, where the transactions were wholly artificial, the motive is clear. The taxpayer entered into the schemes for the sole purpose of avoiding tax. To disallow the effectiveness of such schemes is not to say that a taxpayer must maximize the amount of tax for which he is liable. It means simply that his object of the avoidance of tax by the creation of artificial losses will be unsuccessful. The decision in Furniss v. Dawson cannot be explained so succinctly. There the taxpayers had no intention whatsoever of avoiding tax. They simply did not wish to pay now that they could legitimately pay later. The decision of the House of Lords, of ignoring the step of the transfer to Greenjacket, meant that the taxpayers incurred immediate liability to capital gains tax, that is, before they had received any monetary gain. They had not received cash for the shares they had transferred to Greenjacket but shares in Greenjacket instead. The consequence of this decision, therefore, was that the taxpayers were liable to tax before they had received the actual profit.

Furthermore, what of the principle that a man can organize his affairs in such a way so as to minimize his tax liability? In Furniss v. Dawson it made good

{59 [1982] AC 300 at 326.
60 Id. at 325.
63 [1936] AC 1.
64 [1982] AC 300.
67 Supra.
business sense for the taxpayers to defer their liability to tax, if they were able to do so within the rules. In this sense the case is no different in substance from \textit{IRC v. Duke of Westminster}. \textsuperscript{68} The decision of the House of Lords in \textit{Furniss},\textsuperscript{69} however, severely restricts this right. The fact that the courts had not previously distinguished tax avoidance schemes from tax deferment schemes is no justification for this. Traditionally, the judicial approach to either scheme would have been a step by step examination of each stage in the transaction, as explained above. The new approach of the \textit{Ramsay} principle to tax avoidance schemes meant that the courts were free to look to substance and not form. By extending that approach to tax deferment schemes, the House of Lords made significant inroads into the rights of the taxpayer. By not allowing the taxpayer to organize his affairs to his fiscal advantage, the House of Lords effectively required him to maximize his tax liability. Furthermore, the only way in which one could predict whether the new approach would apply was to examine the motive of the taxpayer. In \textit{Furniss v. Dawson}\textsuperscript{70} the transfer to Greenjacket was made for the sole purpose of deferring the tax liability. In \textit{IRC v. Duke of Westminster},\textsuperscript{71} the Duke's sole reason for paying his servants by deed of covenant was to avoid, or at least minimize, his liability to surtax. What in substance is the difference between the two cases? Lord Bridge said that in \textit{IRC v. Duke of Westminster} the only transaction in question was the covenant in favor of the gardener "and the bona fides of that transaction was never for a moment impugned."\textsuperscript{72} He continued:

When one moves, however, from a single transaction to a series of interdependent transactions designed to produce a given result, it in my opinion, perfectly legitimate to draw a distinction between the substance and the form of the composite transaction without in any way suggesting that any of the single transactions which make up the whole are other than genuine.\textsuperscript{73}

Lord Bridge appears to make the distinction between a one stage transaction and a multi-stage transaction. He is therefore effectively overruling the \textit{Duke of Westminster} in all but name. Taxing statutes have grown considerably in volume and complexity since 1936, so that it is no longer possible to minimize tax liability by one stage transactions. If there is more than one stage the courts are now free to call it "composite" and then look to the substance and not the form.

It was suggested by many\textsuperscript{74} that the House of Lords had gone too far in \textit{Furniss}

\textsuperscript{68} [1936] AC 1.
\textsuperscript{69} [1984] 1 AC 474.
\textsuperscript{70} \textit{Id.}
\textsuperscript{71} [1936] AC 1.
\textsuperscript{72} [1984] 1 AC 474 at 517.
\textsuperscript{73} \textit{Id.} Lord Bridge also referred to the approach taken by the US courts when dealing with these issues, and specifically quoted from the judgment of Judge Learned Hand in Helvring v. Gregory 69 F.2d 809, 810 (2d. Cir. 1934).
\textsuperscript{74} Including the present writer. See The Legal Executive Vol 23 No. Sept 1985; "Inland Revenue Thoughts
v. Dawson because that decision meant that whenever one organized one’s affairs in such a way as to secure a tax advantage, it was open to the courts to disregard what was done. There was no way of knowing in advance what the court would do or what the attitude of the Inland Revenue would be. There had been certainty following the decision in Ramsay in that it was clear that artificial tax avoidance schemes would fail. That certainty was removed by the decision in Furniss v. Dawson.

Attempts were made by the accounting bodies to seek clarification from the Inland Revenue as to when the rule in Furniss v. Dawson would be applied. The accountants were trying to obtain some certainty so that they would have a clearer idea of whether any particular scheme would succeed or fail. The Inland Revenue refused to comment or give any guidance at all.

The final episode in this saga occurred in July 1988 when the cases of Craven v. White, IRC v. Bowater Property Developments Ltd. and Baylis v. Gregory reached the House of Lords. The three appeals were heard together because in each case, although the facts were different, the Inland Revenue was seeking to tax the taxpayer under the principle of Furniss v. Dawson.

The facts of Craven v. White were very similar to those of Furniss v. Dawson. They did differ, however, in one important respect. At the time of the transfer of the shares to the Isle of Man company, the taxpayer genuinely did not know whether the shares would be sold or whether a merger would take place. On these facts the House of Lords, by a 3:2 majority, found in favor of the taxpayers.

The facts in Baylis v. Gregory were also similar. The taxpayer wished to sell a company. He found a purchaser and negotiations took place. Later the sale fell through but the taxpayer decided nonetheless to continue to transfer the shares to the Isle of Man company so that, should another purchaser be found, he could secure a tax advantage. A purchaser was not found until several months later. Again, by the same majority the House of Lords found in favor of the taxpayer and distinguished Furniss v. Dawson.

The importance of the decision of the House of Lords in these conjoined appeals should not be underestimated. Firstly, it should be noted that although the final decision went in favor of the taxpayers and as such it creates good precedent which must be followed, it was only by a 3:2 majority. The two dissenting judges, on Furniss v. Dawson Insolvency Law and Practice Vol 1 No 6 (Dec 1985).


[1984] 3 All ER 945.

[1984] 1 AC 474.

The House of Lords upheld the decisions of the Court of Appeal [1987] 3 All ER 27 and of Peter Gibson J [1985] 3 All ER 125.

The case of Bowater involved Development Land Tax which has since been abolished.
Lords Templeman\textsuperscript{81} and Goff,\textsuperscript{82} could see no material differences between these cases and \textit{Furniss v. Dawson}. In each of the cases, the taxpayers had embarked upon a series of transactions in order to secure a tax advantage. The tax advantage was ultimately obtained. \textit{Furniss v. Dawson} had said that in such circumstances the courts were able to view the substance of the matter, which meant that the artificially inserted steps could be ignored for the purposes of fiscal advantages. Lords Templeman and Goff were strongly of the opinion that the same result should appertain in \textit{Craven v. White}.\textsuperscript{83}

The majority of the House of Lords, however, considered the differences between the present cases and \textit{Furniss v. Dawson} to be material. Their reasoning behind this decision is unfortunately inconsistent in parts. Firstly, it was held that the principle in \textit{Furniss v. Dawson} is applicable only where the senses of transactions was "preordained". This was defined as meaning where the taxpayer had the motive of avoiding tax initially and intended to go through a series of transactions to an identifiable conclusion. In other words, if, by examining the transactions as a whole, it could be said realistically that they constituted a single and indivisible whole, then they were to be treated as such. The test was not whether the tax saving step was effected for the purpose of avoiding tax on a contemplated subsequent transaction. Thus in the case of \textit{Craven v. White} the transaction was not preordained\textsuperscript{84} because the conclusion was not identifiable as the taxpayer genuinely did not know whether the final result would be a sale or a merger. Similarly, in \textit{Baylis v. Gregory}, the transaction was not preordained because the identity of the purchaser was unknown.

It can be argued that \textit{Craven v. White} is different because of the uncertainty of the outcome. \textit{Baylis v. Gregory}, however, is a different matter. Lord Keith said that the transactions were preordained:

\[\text{[I]f, but only if, at the time when the first of them is entered into the taxpayer is in a position for all practical purposes to secure that the second is also entered into.}\textsuperscript{85}\]

The taxpayer in \textit{Baylis} wanted to sell the company. He knew that the sale would occur at sometime in the future but not precisely when. The outcome of the transaction (the sale) was certain, it was merely the timing that was not. This raises the issue of the relevance of the timing. Much reference was made in \textit{Furniss v. Dawson} and subsequent cases to the fact that there the transactions were in all probability over before lunch. In \textit{Craven v. White} even Lord Templeman (dissent-

\textsuperscript{81} [1988] 3 All ER 495 at 503.
\textsuperscript{82} Id. at 530.
\textsuperscript{83} Id.
\textsuperscript{84} [1988] 3 All ER 495. Lord Oliver noted at p. 530 that no doubt the transaction was "pre-conceived", the meaning of which he did not further elucidate.
\textsuperscript{85} [1988] 3 All ER 495 at 501.
ing) said that if there was a substantial interval of time between the two transactions there was probably no scheme. But it is only when the second stage in fact occurred that the courts could ignore the first. The first stage (the exchange of shares with the Isle of Man company) was effective for all purposes, including fiscal ones, until the occurrence of the second. Then, but only then, was it possible to hold that the first stage was a fiscal nullity. It is obviously easier to assess the reality of the matter where the timing of the stages is compacted as in Furniss v. Dawson. But should the final conclusion be different where the timing is extended as in the present appeals? If the answer is affirmative, it raises the unanswerable issue of how long an interval will suffice. It is suggested that the timing should not be material. The taxpayer could always plan ahead. Indeed the taxpayer in Baylis v. Gregory did just that. When the arrangement with the original purchaser collapsed, the taxpayer "saw no disadvantage" in continuing with the transfer to the Isle of Man company. The only reason for that transfer was the motive of securing a fiscal advantage in the future.

This would appear to underline the worst fears following Furniss v. Dawson, namely that it is the motive of the taxpayer that is crucial. In Craven v. White, however, Lords Keith and Oliver stressed the fact that there is no moral dimension by which tax avoidance is to be judged. Lord Oliver said of the decision in Furniss:

"It is equally important to bear in mind what the case did not decide. It did not decide that a transaction entered into with the motive of minimizing the subject's burden of tax is, for that reason, to be ignored or struck down."

If the motive test was the correct one, then the decision in Craven v. White would have been in favor of the Inland Revenue. It was not. It would therefore appear that the relevant factor was the uncertainty of the outcome.

Finally, the majority of the House of Lords placed great emphasis on the

86 Id. at 509.
87 [1984] 1 AC 474. On the issue of timing Lord Jauncey said in Craven v. White [1988] 3 All ER 495 at 541 "It may be said that any formula . . . would make it easy for the taxpayer to avoid tax liability merely by postponing arrangement for the second transaction until after the first had been completed. That is, however, to beg the question. The function of the court is to construe the relevant charging section and to apply it to the facts found. I do not conceive it to be a function of the court to act as the third arm of the Revenue in seeking to attack tax avoidance at large."
88 A similar problem can be found in Inheritance Tax and the meaning of "associated operations." Inheritance Tax Act, Section 268 (1984) provides that where operations are "associated" (as defined) they shall be treated as a single transaction for the purposes of Inheritance Tax. The tax is not assessed until the last of the operation. The problems is how can one tell when the last operation has occurred?
89 [1984] 1 AC 474.
90 [1988] 3 All ER 495 at 500.
91 Id. at 522. Lord Jauncey, who also found in favour of the Inland Revenue, was silent on this point.
92 [1988] 3 All ER 495 at 518.
93 This is more clearly shown by the facts of Craven v. White than by those of Baylis v. Gregory, where the outcome (a sale) was known. It was merely the identity of the purchaser that was not.
decisive factor being a question of construction. Lord Oliver said of *Ramsay*:

"What the case does demonstrate, as it seems to me, is that the underlying problem is simply one of construction of the relevant statute and an analysis of the transaction or transactions which are claimed to give rise to the liability or the tax exemption."

The analysis is both confusing and fallacious. In *Ramsay* the reasoning behind the decision was two-fold. Firstly, the scheme was viewed as a whole because it was found to be a sham and a preordained composite transaction. Secondly, the scheme in *Ramsay* was also found to fail because of the construction placed by the House of Lords on the meaning of "debt on a security" and the fact that "loss" in the statute was construed to mean "actual loss". Thus if the wider implications of the *Ramsay* decision are ignored, the decision, that the taxpayers did not secure a tax advantage, can be explained on the basis of the construction of the relevant statutory provisions. The same cannot be said of *Furniss v. Dawson*. If that case is said to involve a question of construction then it must be that the House of Lords were construing the statute to mean something other than what was expressed by its clear and unambiguous language. The statute specifically provided that an exchange of shares is not a disposal. Capital gains tax is only assessed on the gain accruing on the disposal of assets. Thus if there is no disposal there should be no tax. What the House of Lords did in *Furniss* was to ignore the transfer to Greenjacket, holding that transaction to be a fiscal nullity. If this is to be viewed as a question of construction, that conclusion can only be reached by reading into the statute the words "except where the exchange of shares is part of a wider scheme and the sole motive for entering into that transaction is the saving or avoidance of tax". Such a construction would involve the application of rules of statutory interpretation unknown to English law. One reason for the emphasis on the rationale behind *Ramsay* being a question of construction can be found in the dissenting judgment of Lord Goff. He said:

Any idea that the principle in *Ramsay* is a moral principle, or that it is designed to catch any step taken to avoid tax, is, in my opinion, destroyed by the recognition of the *Ramsay* principle as a principle of statutory construction. Indeed the principle cannot be independent of the statute, for the obvious reason that your Lordships have no power to amend the statute.

Lord Oliver concluded:

"A transaction does not change its nature because of an event, then
uncertain, which subsequently occurs and *Ramsay* is concerned not with reforming transactions but with ascertaining their reality.\(^{99}\)

This again appears to take the issue back to the timing of the transactions. At what point in time it is possible to see the reality of the matter? Lord Oliver is suggesting not with hindsight. But it is only after the occurrence of the second transaction that the reality of the first can be ascertained.\(^{100}\)

In conclusion, it can be seen that the decision in *Ramsay*\(^{101}\) marked the start of a movement away from the traditional approach to the interpretation of taxing statutes. The decision can readily be justified because the scheme involved in that case was wholly artificial. That was not the situation in *Furniss v. Dawson*\(^{102}\) and yet the decision was the same. It is acknowledged that *Furniss v. Dawson* involves an extension of the *Ramsay* principle and it has already been argued that the latter decision went too far. The emphasis placed on the criterion of "no business purpose other than the avoidance of tax" is therefore perhaps the wrong test. The emphasis could instead have been placed upon the whole transaction being a sham (it was in *Ramsay* but not in *Furniss*) or even a distinction drawn between circular and linear transactions. The difficulty with all of these distinctions, as was recognized by Lord Templeman, is that any of them:

"[W]ould revive a surprised tax avoidance industry and cost the general body of taxpayers hundreds of millions of pounds by enabling artificial tax avoidance schemes to alter the incidence of taxation."\(^{103}\)

This, of course, is the minority view, the majority holding that there was a valid distinction between *Furniss v. Dawson* and *Craven v. White*. It could be argued that in the later case the House of Lords impliedly recognized that in *Furniss v. Dawson* they had gone too far. A valid line can be drawn between *Ramsay* and *Furniss v. Dawson* but not between *Furniss v. Dawson* and *Craven v. White*. The reluctance to say so explicitly is obvious for it would involve overruling *Furniss v. Dawson* which would be viewed as a return to the more traditional approach.\(^{104}\) *Furniss v. Dawson* is therefore still good law but has been confined to its facts.\(^{105}\) Nonetheless, it must be acknowledged that the decision in *Craven v. White*\(^{106}\) has given *IRC v. Duke of Westminster*\(^{107}\) a new lease of life. The decision can only encourage the development of even more complicated tax avoidance schemes then existed hitherto.

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\(^{99}\) *Id.* at 527.

\(^{100}\) See *supra* note 73.

\(^{101}\) [1982] AC 300.

\(^{102}\) [1984] 1 AC 474.

\(^{103}\) [1988] 3 All ER 495 at 509.

\(^{104}\) *Supra*.

\(^{105}\) *Id.* This conclusion was recognized by Lord Templemen at p. 509 but was denied by Lord Oliver at p. 525.

\(^{106}\) [1988] 3 All ER 495.

\(^{107}\) [1936] AC 1.
each embracing a multiplicity of possible conclusions. This could lead to very
difficult decisions to be made in the future. Would an even more complicated
Ramsay scheme not succeed?

It is clear, at least, that the English law has sought to do judicially that which
could not be achieved legislatively. To frame legislation in such a way so as to
always produce the "right" result is an impossible task. To allow the genuine
transactions the benefit of tax relief but not those which are artificial could only be
legislatively achieved by the inclusion of a measure of the motive of the taxpayer.
This would be impossible because of the problems of definition and cognizance and
also because all statutory language is open to judicial interpretation. The final result,
however, does mean that the maxim "there is no equity in tax" is now modified. The
substance of the matter can be analyzed in the circumstances of Ramsay and Furniss
v. Dawson but not in those of Craven v. White or Baylis v. Gregory. Thus tax
avoidance schemes are not dead in England but only the most complicated can now
have any chance of success.