

the expenses of the scheme. The money needed for the various steps was lent by a finance house on terms which ensured that the loan came back to the finance house on completion. Against that, the taxpayer's personal outlay was confined to his expenses of the scheme.

In the Appeal Court Lord Wilberforce held that the Court was not confined, in reaching its judgment, to consider each step in isolation for the purpose of assessing the fiscal results. Lord Wilberforce identified Floor v Davis as a case in which it was legitimate to have regard to all the arrangements as a whole. He held:

"... Viewed as a whole, a composite transaction may produce an effect which brings it within a fiscal provision."

He went on to hold:

"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. In each case the facts must be established; and a legal analysis made; legislation cannot be required or even be desirable to enable the court to arrive at a conclusion which corresponds with the parties' own intentions".

The following points emerge from Lord Wilberforce's judgment:

- (a) each scheme consisted of a number of steps to be carried out

according to a timetable, involving documents to be executed and payments to be made, in rapid succession;

- (b) once the scheme was in motion it would not be arrested at any stage. In Eilbeck's case this followed from the contractual nature of the arrangements, while in Ramsay's case there was an expectation that the scheme would be implemented in its entirety;
- (c) although considerable sums of money were involved, the taxpayer did not put his hand into his pocket. The money was provided by a loan from a finance house, and was secured by a charge on the asset which formed part of the scheme. When the transactions were completed the loan was repaid;
- (d) the purpose of the scheme was the avoidance of tax;
- (e) the principle established in the Duke of Westminster case should not be overstated or over-extended. It does not compel a court to look at a document or a transaction in blinkers. If a document or transaction is part of a series of transactions or a wider transaction intended as a whole, the court can regard it as such. The court should ascertain the legal nature of the transactions. To do so it may be necessary to consider each step in a composite transaction intended to be carried through as a whole;

- (f) a number of cases have illustrated the limitations of the Duke of Westminster doctrine, notably Floor v Davis (1979) STC 379 (HL), IRC v Plummer (1979) STC 793 (HL) and Chinn v Collins (1981) STC 1 (HL);
- (g) the argument advanced for the taxpayer, that if the Crown's contention for a wide meaning was accepted it would necessitate rejecting accepted and established canons of interpretation, and that it was for Parliament to enact widely drawn provisions to counter tax avoidance schemes, was rejected. Lord Wilberforce held that the Court's approach did not involve a new principle. The Court had both the power and duty to determine the nature of sophisticated legal devices and to relate them to existing legislation. The courts are not obliged to stand still, because if they do it might result in loss of tax, prejudice to other taxpayers, Parliamentary congestion, or all three. Any other approach would be a denial rather than an affirmation of the judicial process.

David Goldberg, writing in the 1981 British Tax Review 233 points out that in a system of judicial precedence, the highest court in the land does not make law, but it states what the law is. However, where the statement of the law conflicts with earlier statements as to what the law is or what it was, (e.g the Duke of Westminster case) it can lead to difficulties in interpretation. He remarks that

but for the approval, "given in an almost throw-away fashion," of Eveleigh's LJ dissenting judgment in Floor v Davis by the House of Lords in Ramsay and Rawling, those decisions would not have had the shock wave effect which they had, and which, it may be added, have been perpetuated in Furniss v Dawson, infra.

It was thought, after Ramsay, that if a scheme did not have the characteristics postulated by Lord Wilberforce, the Ramsay principle would not apply. This theory was upset in Burmah Oil, infra where Lord Scarman held:

"It is of the utmost importance that the business community (and others including their advisors) should appreciate, as my noble and learned friend Lord Diplock has emphasised, that Ramsay's case marked a significant change in the approach adopted by this House in its judicial role towards tax avoidance schemes".

In IRC V Burmah Oil Company Limited (1982) STC 30 it was accepted that the scheme could have been stopped half way through, and that the money necessary to put the scheme through was "real money" and was provided by the Burman Oil Company. The taxpayer was saddled with a subsidiary which owed it money and which was making losses. The taxpayer injected money into the subsidiary through an issue of redeemable preference shares. The money was used by the subsidiary to repay the debt, and the subsidiary was wound up. The investment was written off. Some of the points listed by Lord Wilberforce in

Ramsay were not present in Burmah Oil, but the taxpayer still lost. In both cases it was found that the transactions were not shams. The Revenue failed in attacking the technicality of the scheme, but succeeded on the Ramsay principle. The court held that the scheme as a whole was a fiscal nullity. Although the House of Lords could have held that Duke of Westminster was wrongly decided, it did not do so. The Duke of Westminster is authority for the proposition that if a document or transaction is genuine, the court could not look behind it, at the substance of the transaction. The Duke of Westminster was, however, distinguished in Ramsay on the grounds that even if the documents were genuine, the Court should look at the transaction as a whole.

In Ramsay the House of Lords went much further than the Revenue asked them to do. In the Crown's argument in reply Peter Millett QC said:

"The Crown do not suggest that the House should adopt the widest principle of "the multiple step transaction" adumbrated in the United States of America. The doctrine which the Crown invites the House to adopt is narrow and is confined to self-cancelling transactions, in which an allowable loss is manufactured by an artificial transaction with no effect except to generate the claim."

As I have pointed out Lord Wilberforce went much further than that.

In Coates v Arndale Properties Limited (1982) STC 573 the principles

of Ramsay and Burmah Oil were extended further, and they have been extended still further in Furniss v Dawson, infra.

In Coates v Arndale Properties Limited [1984] 1 WLR 537(CA) the taxpayer, a member of a group of companies, acquired at market value from another member of the group an asset of a kind in which it traded and in relation to which the selling company had sustained a capital loss. The taxpayer contended that it had acquired the asset as "trading stock" within the meaning of the relevant statutory provisions, and claimed the capital loss of the selling company as a trading loss. The Inspector of Taxes contended that the purpose of the acquisition was purely fiscal, and this prevented the asset from being acquired as "trading stock".

It was held by Lawton LJ, at p.543, that if the acquisition of an asset lacks a commercial character it cannot have been said to be acquired as trading stock. He went on to hold:

"... [The Commissioners] should have looked at the transactions as a whole and should not have confined themselves to the legal effect of the two assignments. The transactions do not bear the badges of trade. Within the group there was no commercial reason why SPI should not have assigned the lease directly to APTL. No cash passed. The profit to APL of £10 000 could not have been much of an incentive for the assignment to APTL because on its face no provision was made for profit. The assignment through APL could only have been made for the purpose of getting a fiscal benefit ..."

In the result the appeal was upheld, and leave to appeal to the House of Lords has been granted. The Revenue's success in attacking a single transaction within a group of companies, on the grounds that it should be ignored if it was motivated by fiscal advantages rather than a commercial purpose, will have far reaching consequences. For example, fiscal incentives such as investment incentives which are designed to encourage a particular course of action can not be relied upon to give the advantage sought, because by definition their use would have been motivated by the objective of securing the tax advantage.

This review demonstrates, I think, how the judiciary have swung away from the early approach to tax matters, towards a robust and aggressive attitude against tax avoidance. It is, however, difficult to distil a principle of law from the decisions in these cases.

Chapter Four

Furniss v Dawson

In this chapter I shall deal separately with the decision of the House of Lords in Furniss v Dawson. This case will be of great importance, not only in the United Kingdom, but also in South Africa and in Australia. One of the reasons for its importance was that it was a simple tax deferment scheme, and not an elaborate device. Despite this the taxpayer failed.

In IRC v Kleinwort Benson Ltd [1969] 2 All ER 737 it was held that in determining whether a transaction was carried out for bona fide commercial reasons or to obtain a tax advantage the subjective intention of the people controlling the company must be determined as a question of fact. Where there are two ways of carrying out a commercial transaction, by one of which the maximum amount of tax would be payable and by the other of which no tax or much less tax would be payable, it would be wrong to draw as a necessary inference that in adopting the latter course one of the main objects is enabling tax advantages to be obtained. IRC v Brebner [1967] 1 All ER 779.

The concept of "avoidance" is not always easy to define. The courts have rejected the view that there can be "proper" or "improper" tax avoidance (see Lord Wilberforce in Mangin v IRC [1971] 1 All ER 179 at 190) but the position remains unclear. There are, for example, a number of cases in tax legislation where the "motive" or "purpose" of a transaction may bring a case within a particular anti-avoidance section. Over the last twenty or thirty years, as businessmen have become more sophisticated, virtually every business decision is evaluated in after-tax terms. Consequently, it is not possible to assert that there is no tax "motive" or "purpose" in deciding between a number of possible ways in which to carry out a commercial transaction. Where important contracts are involved it is also difficult to say that tax was not one of the main considerations in determining which route should be used.

In Furniss vs Dawson [1984] 1 All ER 530 (HL) the House of Lords had to consider a tax deferment scheme. The scheme did not have the extravagances associated with tax avoidance schemes: These were described, in the majority judgment, as cases where a taxpayer who had been fortunate enough to realise a capital profit, had, with the aid of astute advisers, manufactured out of a string of artificial transactions a supposed loss in order to counteract the profit which had been made. On the contrary, the tax deferment scheme in issue was classified by Lord Brightman at p. 536, as "simple and honest", one in terms of which the taxpayer sought to defer payment of tax until he received the gain which he had made.

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The taxpayer, his wife and sons held shares in two operating companies which manufactured clothing. They held all the shares in one company and most of the shares in the other company. It was agreed that a third company would buy the entire shareholding in the operating companies. The capital of the operating companies was re-organised, so as to include the issue of renounceable letters of allotment in order to minimise the stamp duty payable on the purchase. Acting on advice, the taxpayer and his family arranged to exchange their shares for shares in an investment company, which was to be incorporated in the Isle of Man. A company called Greenjacket Investments Limited was incorporated for this purpose. The subscribers to the memorandum of Greenjacket were members of a Manx firm of solicitors, who were nominated as the first directors pursuant to a meeting of the subscribers. At the meeting the directors considered an agreement by which Greenjacket would purchase the shares in the operating companies for £152 000, to be satisfied by the issue of shares in Greenjacket, and an agreement in terms of which Greenjacket would sell the shares in the operating companies to the purchasing company for £152 000. These transactions were authorised.

Meetings of shareholders were held in England for the purpose of sanctioning the sale and to authorise the taking of statutory steps. These were performed simultaneously with transactions in the Isle of Man to give effect to the sale and transfer of shares. The court had

regard to the fact that all of these meetings were planned and executed with faultless precision, commencing at 12.45 pm on the day in question, so that the meetings were "presumably concluded in time for lunch."

Section 19 of the Finance Act, 1965, charges tax in respect of capital gains accruing to a person on the disposal of assets. In terms of the Finance Act the taxpayer and his family were assessed to capital gains tax. The original argument for the Revenue was that Greenjacket did not acquire control of the operating companies in terms of Paragraph 6 of the 7th Schedule, which provides exceptions in the case of company amalgamations. One exception would apply to shares in a company transferred to another company, which acquires control in exchange for shares in the transferee company. In that case there is deemed to be no disposal of the former shareholding, but the new shareholding and the old shareholding are treated as the same asset. The taxpayers contended that Greenjacket did acquire control of the operating companies, and therefore that any charge to capital gains tax would be deferred until they disposed of their shareholding in Greenjacket and realised a chargeable gain. The point in issue was whether Greenjacket acquired control of the operating companies. On appeal in the House of Lords that question had to be answered in a different legal context from that in which it was originally considered, because the law had changed.

The Special Commissioners had held that Greenjacket had acquired control of the operating companies, and therefore that the first sale agreement was not a disposal by the taxpayer to Greenjacket for the purposes of capital gains tax. Their decision was given on 21 January 1976. In the meantime, a "significant change in the approach adopted by this House towards artificial tax saving schemes" occurred, see IRC v Burmah Oil Company Limited, supra, per Lord Diplock.

In Ramsay (supra) Lord Wilberforce had re-stated four principles, namely:

- (a) when construing a taxing act the courts are not confined to a literal interpretation. The context and scheme of the act, and its purpose should be considered;
- (b) a taxpayer can organise his affairs to reduce the incidence of tax. What he does is to be judged according to its legal effect. Once the existence of a tax avoidance scheme is recognised, which would produce tax consequences, the legal effect of the steps in the scheme must be analysed accordingly;
- (c) documents and transactions are either genuine or sham. (This may cause difficulties, because it raises the question whether scheme documents are genuine or sham. It also raises a

difficulty of concept, because in a tax avoidance scheme the purpose is to prevent a genuine loss or payment and it is not a sham. It is therefore likely that some time will elapse before this principle is defined with certainty);

- (d) given that a document or transaction is genuine, the court may not go behind it to a supposed underlying substance not revealed in the document. If the document or transaction is part of a nexus or series of transactions, so to regard the transaction is not to prefer substance to form. This is the "significant" new approach of the House of Lords, for if all the steps in a series of transactions may be viewed together, and not one by one, and if their effect in law is the effect of the series, this will increase the chance of a realistic assessment of tax avoidance schemes. (See Monroe 1982 BTR 205 - 206).

In Furniss v Dawson counsel for the taxpayer laid emphasis on the fact that the transactions were not "self-cancelling", as they had been in Ramsay's case. Greenjacket was brought into being for an indefinite period, and the consideration paid by the purchaser,-- which was the foundation of the capital gain, would never reach the hands of the taxpayers, save by way of loan, unless and until Greenjacket was wound up or its capital was reduced.

In Burmah Oil supra Lord Diplock had held:

"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 pre-ordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable. The difference is in approach. It does not necessitate the overruling of any earlier decisions of this House; but it does involve recognising that Lord Tomlin's oft-quoted dictum in IRC v Duke of Westminster (1936) AC 1 at 19, [1935] ALL ER 259 at 267, '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', tells us little or nothing as to what methods of ordering one's affairs will be recognised by the courts as effective to lessen the tax that would attach to them if business transactions were conducted in a straightforward way".

Lord Diplock's warning was repeated by Lord Scarman, who held:

"First, it is of the utmost importance that the business community (and others, including their advisers) should appreciate, as my noble and learned friend Lord Diplock has emphasised, that Ramsay's case marks "a significant change in the approach adopted by this House in its judicial role" towards tax avoidance schemes. Secondly, it is now crucial when considering any such scheme to take the analysis far enough to determine where the profit, gain or loss is really to be found."

As I have pointed out Burmah had involved a series of pre-ordained steps in which a number of other steps without commercial purpose

apart from tax avoidance appeared. Burmah had a subsidiary which was indebted to it, and whose prospects of repaying the loan were remote. Burmah put money into the subsidiary by way of redeemable preference shares, which was used to repay the debt. The subsidiary was liquidated with a consequent loss. The House of Lords refused tax relief for that loss. It viewed the fact that the money had gone round in a circle, as a result of which Burmah was neither richer nor poorer commercially speaking, although fiscally the previously valueless debt and non-allowable loss was converted to valueless shares and an allowable loss, as a series of artificial steps.

In Furniss v Dawson, in the court of first instance, Vinelott J ruled that the principles established in Ramsay and Burmah would not apply, and that a transaction cannot be disregarded and treated as being a fiscal nullity if it has "enduring legal consequences". He was able to identify "enduring legal consequences", in the fact that Greenjacket beneficially owned the proceeds of sale of the shares in the operating companies, on the income of which Greenjacket was liable to tax, and that the purchaser's rights under the second sale agreement lay against Greenjacket, and not against the taxpayers. The fact that the parties contemplated a further sale did not alter the situation. By this approach Vinelott J confined the Ramsay principle to self cancelling transactions, as opposed to transactions having enduring legal consequences. Vinelott J was able to reconcile Ramsay and Burmah on the ground that in Ramsay there

was no real loss, because it was of the essence of the facts in Ramsay that there should be no real loss. Vinelott J held that where a scheme embodies circular or self-cancelling steps the court may treat these as a fiscal nullity if the change in position is one in form and does not create enduring legal consequences.

The House of Lords rejected Vinelott's J approach. It also rejected the approach adopted in the Court a quo by Oliver, Kerr and Slade LJ: Slade LJ remarked, in the course of his judgment, that the references to Floor v Davis were clearly "a convenient mode of illustrating the broader approach to tax avoidance schemes which (their Lordships) were concerned to establish". The House of Lords said this was a means of "freeing himself from the uncomfortable shackles of judicial precedent". The House of Lords referred to Oliver's LJ approach to the decision in Floor v Davis as being "totally untenable". The House of Lords dismissed Kerr's LJ judgment with the phrase ".... adopted the reasons and hence the errors of Oliver LJ".

The House of Lords ruled that in a pre-planned tax saving scheme no distinction is to be drawn for fiscal purposes, because none exists in reality, between ..

- (i) a series of steps which are followed through by virtue of an arrangement which falls short of a binding contract; and

- (ii) a series of steps which are followed through because the participants are contractually bound to take each step seriatim.

The House approved the formulation of Lord Diplock in Burmah Oil, namely that there may be a pre-ordained series of transactions, or one single composite transaction. This transaction may or may not include the achievement of a legitimate commercial or business end. Secondly, there must be steps inserted which have no commercial or business purpose apart from the avoidance of a liability to tax, not "no business effect". If those ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result, and the way in which the taxpayer will be taxed will depend on the terms of the taxing statute in question.

This review of Furniss v Dawson and of the change in emphasis on "form" and "substance" in income tax cases over a number of years demonstrates again the change towards a purposive approach. It also shows the extent to which the judiciary have taken upon themselves the right to legislate to fill the gaps which they perceive to exist in the legislation. The jurisprudential concept of this approach is almost impossible to define, because it depends on the personal views of the judge who hears the case.

Chapter Five

Bond washing and dividend stripping

In the United Kingdom avoidance provisions were enacted to counter devices known as "bond washing" and "dividend stripping" which were popular in the 1950's and early 1960's before capital gains tax was introduced.

In "bond-washing" a higher rate taxpayer would sell his rights, dividends and/or interest in his securities for a capital sum to a non-taxpaying body such as a charity or pension fund. The capital sum would not be taxable in the hands of the taxpayer, and the non-taxpaying body could reclaim the tax deduction from the dividend and/or interest.

"Dividend stripping" is a device by which a purchaser obtains control of a company which has accumulated profits or reserves, by purchasing the company's shares. The purchaser then arranges for the profits to be distributed to itself by way of dividends. The shares in the company, stripped of its reserves, are sold at a loss, and the purchaser obtains repayment of the tax deemed to have been deducted in arriving at the figure of profits distributed as dividends. This results in the payment of tax constituting a cash

profit. This has an effect on a company's capital gains tax liability.

Prior to the introduction of legislation the schemes were challenged on the basis that the transactions were not "trading transactions", but were what were described as "planned raids on the Inland Revenue", per Lord Donovan in Lupton v FA and AB Ltd (1971) 47 TC 580 at 629.

In J P Harrison (Watford) Ltd v Griffiths (1962) 40 TC 281, Finsbury Securities Ltd v Bishop (1965) 43 TC 591; Lupton v FA & AB Ltd (1971) 47 TC 580 and Thomson v Gurneville Securities (1969) 47 TC 633, the question arose as to whether the purchase and sale of securities constituted trading transactions, when at the same time there were dividend payments and income tax repayment claims. All four cases were taken to the House of Lords.

In J.P. Harrison (Watford) Ltd v Griffiths, *supra*, a company trading in merchandise changed its memorandum in order to allow dealing in shares. The company had incurred substantial losses as merchants. It purchased the shares of a company with large accumulated profits, described by the Commissioners as "a company pregnant with dividend". The profits were distributed in the form of dividends, and the shares were sold at a loss. The company reclaimed the tax deducted from the dividends on the basis that the gross dividends

were less than the losses from share dealing and trading as merchants.

In the House of Lords, by a majority of three to two, it was held that the fiscal motives were irrelevant to the question of whether the transactions were of a trading nature. Lord Morris, one of the majority, made the following points:

- (a) On the facts, the transaction was not a sham, but amounted inherently to share dealing;
- (b) the inherent nature of the transaction was unaltered by the taxpayer's object in entering into the transactions to secure a tax advantage;
- (c) the object and intentions of the taxpayer may be relevant in some circumstances, and the fact that a trader even envisages making a loss will not deprive a trading transaction of its nature as trade;
- (d) trading transactions can be the prelude to the recovery of tax when the recovery is made in the capacity as a taxpayer and not as a trader. The fact that a trader has in his eye the recovery of tax will not deprive a trade of that description.

The minority, Lord Reid and Lord Denning, held that an isolated transaction, not effected with the object of making a profit, provided some ground for arguing the transaction did not amount to trading. Lord Reid dismissed the argument that one should examine only the transaction and not its purpose or effect. This view has since been adopted in Finsbury Securities, Lupton and Thomson. However, as was pointed out in Coates v Arndale Properties, the House of Lords has not yet overruled its finding in Harrison.

In his judgment Lord Denning held that the Court should not close its eye to the second part of the transaction, namely, the recovery of tax on the dividend, but that one had to look at the transaction as a whole. On that basis he held, at p 300:

"To my mind, the Commissioners were entitled to see these people as they really are, prospectors digging for wealth in the subterranean passages of the Revenue, searching for tax repayments. They are not simple traders dealing in stocks and shares."

In Finsbury Securities, supra, a case of "forward" stripping, the House of Lords unanimously held, following Harrison's case, that there were no elements of trading present in the transaction. In "forward" stripping the dealer buys shares in a company which hopes to make large profits and distribute dividends. As dividends are received annually the lump sum paid for the shares is reduced downwards, and a tax loss created. On the facts it was held that the future interests of the vendors were safeguarded, as they retained the benefits which would have accrued had there been no scheme,

whilst the purchasers were precluded from dealing in the shares, but had to retain them for the minimum period of five years, and so had the characteristics of fixed assets rather than stock-in-trade. Accordingly, the House of Lords rejected the argument that the purchaser was a share dealer, entitled to deduct the loss made when the shares were sold. It held that the shares were acquired in order to be retained, and not for the purpose of dealing in them.

In Lupton's case, supra, a share dealing company specialising in dividend stripping purchased the shares of a company with a substantial accumulated profit and investments of about £700 000. It was agreed that if the share dealing company recovered any tax on the reduction in value of the shares acquired as a result of the dividend payment, the tax recovered would be divided between the vendor and purchaser equally. The House of Lords held that the transaction was not carried out in the course of the appellant's trade as share dealers. Lord Morris delivered the leading judgment. At 621, he cited with approval Megarry J in the court below as follows:

"The question is, whether viewed as a whole, the transaction is one which can fairly be regarded as a trading transaction. If it is, then it will not be denatured merely because it was entered into with motives of reaping a fiscal advantage. Neither fiscal elements nor fiscal motives will prevent what in substance is a trading transaction from ranking as such. On the other hand, if the greater part of the transaction is explicable only on fiscal grounds, the mere presence of elements of trading will not suffice

to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an artificial structure, remote from trading and fashioned so as to secure a tax advantage, the mere presence in that structure in certain elements which by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure."

Lord Donovan distinguished the case from cases such as Harrison, on the basis that in the latter case the fiscal advantage was incidental.

In his judgment Lord Donovan declared that the transaction constituted:

".... the execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapon."

In Thomson v Burnet Securities Ltd, supra, the substance of the transaction was that a share dealing company would incur a loss as a result of writing down the value of its shareholding in another company, as a result of dividends paid by the other company. The case differed from Lupton because a small commercial profit was included in the arrangements, which was about one-fifth of the loss claimed in respect of the dividend stripping transactions. The House of Lords unanimously held that the transactions were not trading transactions of a share dealer. Lord Simon held, after commenting that the commercial profit was of a very curious nature, that:

"In the instant case the question can be narrowed: looking at the transaction as a whole, was it, on the one hand, one whereby a true commercial profit was taken in a fiscally advantageous way, or, on the other, one in which a commercial profit was really a by-product of, or a disguise for, what was a really a tax recovery device? Whichever way the question is put, I have no doubt that judged both qualitatively and quantitatively the transaction falls into the latter category in each case."

As appears from these cases the decision in Harrison was based on a narrow view. It has been superseded by a wider approach in which the transaction is viewed as a whole. Doing this comes close to abrogating the rule established in Duke of Westminster, that it is the form of the transaction and not its substance which determines its status. This trend has been dealt with in regard to Ramsay and Furniss, although the House of Lords has, up until now, refused to overrule its decision in the Duke of Westminster, nor has it overruled its decision in Harrison's case.

Chapter Six

Summary of the position in the United Kingdom

The review of the decisions in a number of cases spanning more than a century show, in my view, how the pendulum has swung, from Lord Cairns adopting two irreconcilable methods of interpretation where taxing and other statutes were involved, through a spectrum of cases emphasising the immorality of tax avoidance, to Furniss v Dawson, where the House of Lords has virtually adopted a test of motive and morality. Furthermore, given the fact that in any commercial transaction the after-tax position almost entirely determines the nature and structure of the deal that is struck and the form it will take, the taxpayer's prospects of avoiding tax in virtually any situation look bleak.

On this review of cases in the United Kingdom, and having regard to the decisions in Ramsay, Burmah Oil and Furniss, it is apparent that in any case the taxpayer must be able to justify the scheme or transaction on sound commercial reasons. The reaping of a fiscal advantage without any commercial justification for the deal will fall foul of the courts. It is difficult to say what the success of

a "mixed" scheme would be, but it seems that the further one moves along the scale from pure "fiscal advantage" to pure "commercial reasons" the more likely it is that the taxpayer would succeed in justifying what he did so as to avoid the tax net.

It is also evident that the "form" and "substance" doctrine can not be easily defined, nor does it seem to have any value in determining the way in which a court will react to the scheme under consideration. The taxpayer who intends to embark on a scheme must be aware of the approach the courts are likely to take. It is apparent that the courts will look closely at the taxpayer's motives, and with that in mind will consider the fiscal advantages he achieved.

Finally, it is evident that a strict or legalistic approach towards the interpretation of taxing statute's is no longer the order of the day. The courts will apparently adopt a pro fiscus approach when called on to interpret tax legislation.

It is clear that a tax adviser in the United Kingdom, and, as I shall show, in South Africa as well, should ensure that his client makes use of the reliefs or provisions in the taxing statutes which are self evidently intended to be used by taxpayers, and which are within the spirit and scheme of the legislation. The search for loopholes which are potentially vulnerable to judicial

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disapprobation will be an expensive exercise in the long run. As Broomberg puts it in Tax Strategy, a taxpayer should observe the three precepts of restraint, probity and vigilance. It is possible that not enough attention is paid to the first two precepts both in the United Kingdom and in South Africa.

Chapter Seven

Tax avoidance in Australia

The national climate in Australia in regard to tax avoidance places the activity almost on a level with tax evasion. The Government estimates that it has lost thousands of millions of dollars in revenue through avoidance in the 1970's. It has been described by the Prime Minister of Australia as "morally reprehensible"; so the Government contends that anti-avoidance provisions with retrospective effect are justified on the basis that tax avoidance by a wealthy few casts a greater burden on the general body of taxpayers.

The economic climate of the 1970's brought a new dimension to tax avoidance and evasion in Australia. Avoidance schemes were marketed on a professional level with glossy brochures and by salesmen earning high commissions. The schemes relied on loopholes in the tax act and on the courts' "strict letter" approach, in which form is preferred to substance, so that if a taxpayer can so order his affairs as to place himself outside the tax laws, he will not be construed as being within them on the basis of "fairness" or

"morality". One scheme, known as the Slutzkin Scheme, was marketed with great success. It involved the acquisition by scheme promoters of shares in companies with a potential tax liability prior to the end of the year, at which time the tax liability would be fixed, for a consideration of up to 90% of the assets of the company. No provision was made for tax. It was understood that the promoters would involve the company in a tax avoidance scheme, and would cause the company to pay its tax in the event that the scheme failed. It emerged, subsequently, that the shares were sold on to others, who were appointed directors, that no tax avoidance scheme was engaged upon, and that the company was denuded of its assets and rendered unable to pay its tax when due. Returns were not lodged by the company with either the Revenue or corporate authorities. In terms of a High Court decision in 1977, referred to later on, the vendor of the shares was held to be not taxable on the price he received. Legislation was introduced, to apply to sales of shares in a "relevant company" between 1 January 1972 and prior to 4 December 1980, the effect of which is to require the vendors of shares in those companies and the promoters of the scheme to pay, as a tax, the amount of income tax and undistributed profits tax unpaid by the company. In that climate, therefore, the likelihood of judicial legislation supervening looks strong.

Chapter Eight

Attitudes of the Australian judiciary
to interpretation of fiscal legislation

Since 1877 Australian taxing statutes have included a general anti-avoidance provision. In 1936 the Income Tax Assessment Act (ITA Act) was enacted, which set out, in section 260, a general anti-avoidance provision.

Section 260 reads:

"Every contract, agreement or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly -

- (a) altering the incidence of any income tax;
- (b) relieving any person from liability to pay any income tax or make any returns;
- (c) defeating, evading or avoiding any duty or liability imposed on any person by this Act; or
- (d) preventing the operation of this Act in any respect,

be absolutely void as against the Commissioner, or in regard to any proceedings under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose."

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In Commissioner of Taxation v Patcorp Investments Limited (1976) 140 CLR 247 the stripped company, in which shares were acquired, had substantial accumulated profits available for distribution. It was not engaged in any business activity and had no assets other than cash and debts owed to the company. The appellants agreed to purchase the shares in the stripped company, which, in some cases, was financed by a loan from the stripped company. The amounts due as debts to the stripped company were liquidated in cash, after which, share transfers having been approved and registered, a dividend was paid out of the accumulated profits to the shareholders who were registered. It was common cause that the appellants were carrying on a business of share trading, but the Commissioner argued that the transactions were not entered into in the course of the appellants' ordinary share trading business. It was argued for the appellants that they were motivated by fiscal advantages in entering into the transactions, which could lead to a loss on the purchase and sale of the shares.

On appeal it was held that section 260 had no application to a dividend stripping operation where the question involved was an entitlement to a rebate, which was granted to a taxpayer in terms of the Act. Consequently, the cost of the shares acquired as trading stock was an allowable deduction on disposal, even where the shares had been acquired as a dividend stripping proposal, and that fact did not prevent them from being trading stock.

In reaching his judgment Gibbs J considered the approach adopted by the House of Lords in FA and AB Ltd v Lupton, supra, and Thomson v Gurneville Securities Ltd, supra. He distinguished their reasoning and went on to conclude that as the two sets of statutory provisions were not the same, it was not necessary to reconsider the earlier decision in the High Court in the light of the decisions of the House of Lords.

Gibbs J, as he then was, held at 292, in regard to section 260:

".... The scheme of the English legislation is very different from that of the Australian Act. In particular the English legislation does not contain a provision like section 260, which is aimed generally at tax avoidance. The presence of section 260 makes it impossible to place upon other provisions of the Act the qualifications which they do not express, for the purposes of inhibiting tax avoidance. In other words it is not permissible to make an implication which does what section 260 fails to do. If it is suggested that a taxpayer has engaged in a device to secure a fiscal advantage, and the relevant provisions of the Act do not expressly deal with the matter, the case depends entirely on section 260."

The terms of section 260 proved ineffective in countering a number of artificial tax avoidance schemes which were introduced during the 1970s. Many of these, eg Slutzkin, were the subject of retrospective amendments to the ITA Act. In addition, new general anti-avoidance provisions were inserted as Part IV A of the ITA Act. These provisions preclude a taxpayer from, for fiscal purposes, obtaining a tax benefit which arose from the entry into of a "scheme", the

objective purpose of which may be seen to be that of enabling the taxpayer to obtain that tax benefit. The tax benefit might be either the avoidance of or inclusion of taxable income, or the obtaining of a deduction. The provisions are so widely drawn that a literal interpretation of them would go so far as to nullify, for tax purposes, the transfer by a husband to his wife of income-producing property. It is anticipated that the Commissioner will only rely on these provisions where schemes which may be described as "blatant, artificial or contrived" are created, assuming that the courts do not limit the ambit of the words in interpreting them.

As in the United Kingdom, in Australia it has been held that the:

"fundamental object of statutory construction in every case is to ascertain the legislator's intention by reference to the language of the instrument used as a whole. But in performing that task the courts look to the operation of the statutes according to its terms and to legitimate aids to construction".

See Cooper Brookes (Wollongong) (Pty) Ltd v FC of T (1981) ALJR 434 per Mason and Wilson JJ at 443 (HCA).

Similarly, it was held in FC of T v Westraders (Pty) Ltd (1980) 144 CLR 55 by Barwick CJ at 59-60, that:

"It is for the Parliament to specify ... the circumstances which will attract an obligation on the part of a citizen to pay tax. The function of the

Courts is to interpret and apply the language in which the Parliament has specified the circumstances ... It is not for the Courts to mould or to attempt to mould the language of the statute so as to produce some result which it might be thought the Parliament may have intended to achieve though not expressed in the actual language employed."

In Westraders the appellant had joined a partnership which engaged in the purchase and sale of shares. The partnership acquired from one of the partners, Jensen, a substantial parcel of shares. Jensen had been engaged in the purchase and sale of shares for a number of years, claiming that it was part of its business activities and that it was a share trader. Some of the shares had been acquired for the purpose of stripping the companies of dividends, while others were acquired under schemes by which the value of the shares after declaring dividends were substantially reduced. The shares were transferred by Jensen to the partnership at cost, in consideration for which it received a fee varying between 15 and 20% of the "tax loss". The fee was non-refundable. Total fees paid aggregated more than \$1 000 000. On appeal a restricted interpretation was given to section 260. In the Court a quo it was held that the submission that the appellant availed itself of a permissible deduction, and therefore that section 260 applied for no other reason than the appellant's method of organizing its affairs so as to avoid the incidence of tax would attract the attention of, and would bring it within the ambit of section 260, was without substance.

In Slutzkin v FC of T (1977) 140 CLR 314; 7 ATR 166, the appellants were trustees of four separate trusts in which the beneficiary was either Slutzkin's son or his daughter. The company was established in 1964 with differential classes of shares. The company evolved a scheme by which profits were retained for use as working capital and provision would be made for the children. Originally, the company acquired shares in a trading company, which were sold to another company. After this sale the company conducted no business except the lending of money. It was decided to sell the shares in the company for a price equivalent to its net tangible assets to Cadiz Court (Pty) Ltd, a company involved in dividend stripping operations. All the liabilities of the company were discharged and its assets were converted into cash. The shares were sold and transferred and the directors resigned. After the sale had taken place the purchasers carried out a dividend stripping operation, and then sold the company as an "excess distribution" company. The trustees, as former shareholders, had no interest in this activity. Barwick CJ, at 317, citing with approval a passage from a decision of the Privy Council in IRC(NZ) v Europa Oil (NZ) Ltd (1971) AC 760 at 771, held:

"There is no room in (this) area for any doctrine of economic equivalence. To the legal form and consequence of the taxpayer's transaction, which in effect must be given."
economic equivalence. To the legal form and consequence of the taxpayer's transaction, which in effect must be given."

In Europa Oil (NZ) Ltd (No 2) v IRC (NZ) 5 ATR 744 at 753 it was held, in relation to section 108 of the New Zealand Act, that:

"There are several things to be noted in connection with the application of this section.

First, it is not a charging section; all it does is to entitle the Commissioner when assessing the liability of the taxpayer to income tax to treat any contract, agreement or arrangement which falls within the description in the section as if it had never been made. Any liability of the taxpayer to pay income tax must be found elsewhere in the Act. There must be some identifiable income of the taxpayer which would have been liable to have been taxed if none of the contracts, agreements or arrangements avoided by the section had been made.

Secondly, the description of the contracts, agreements and arrangements which are liable to avoidance presupposes the continued receipt by the taxpayer of income from an existing source in respect of which his liability to pay tax would be altered or relieved if legal effect were given to the contract, agreement or arrangement sought to be avoided as against the Commissioner. The section does not strike at new sources of income or restrict the right of the taxpayer to arrange his affairs in relation to income from a new source in such a way as to attract the least possible liability to tax. Nor does it prevent the taxpayer from parting with a source of income."

In the result, Barwick CJ found it unnecessary in Slutzkin to reconcile the reasoning in various decisions, relying on the decisions of the Privy Council in the Europa Oil cases, on the grounds that these stated fundamental considerations which resolved the matters on appeal.

Since Westraders case was decided, the House of Lords has given its judgment in Ramsay and in Furniss v Dawson. Furthermore, Section 15AA has been introduced into the Commonwealth Act Interpretation Act, 1901. This requires a court construing a Commonwealth Act to

prefer a construction which will promote the purpose or object underlying the act under consideration in cases where the court is faced by possible alternative constructions. In addition, in FC of T v Ilvery (1981) 81 ATC 461, Northrop and Sheppard JJ, at 463, held, in relation to Ramsay, that:

"What their Lordships have said is as apt for the Australian legislation as it is for that enforced in the United Kingdom."

In expressing this opinion they did not refer to Patcorp's case.

It would seem, therefore, that a trend towards judicial legislation is developing in Australia which is likely to follow the same course as it has done in England. Thus far Australian courts have followed a strict legalistic approach to interpretation. Having regard to the approach adopted by the House of Lords in Furniss and in Ramsay it is likely to be a matter of time before the High Court follows that course, either because of a change in attitude, or because the Privy Council may be called upon to decide a case.

Section 260 has two aspects, which relate to its scope and to the consequence of its application. If section 260 is construed literally, it would extend to every transaction, whether voluntary or for value, which has the effect of reducing the tax liability of an individual. Taken to this extreme, the section would become

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