

The Journey's End?

Mawson/Scottish Provident

Lord Scarman, in a two-paragraph judgment in *Furniss v Dawson*, stated:¹

'Whatever a statute may provide, it has to be interpreted and applied by the courts: and ultimately it will prove to be in this area of judge-made law that our elusive journey's end will be found.'

13 years later in *IRC v McGuckian* the House of Lords returned to the same theme. Lord Cooke explained:²

'Always one must go back to the discernible intent of the taxing Act. I suspect that advisers of those bent on tax avoidance ... do not always pay sufficient heed to the theme in the speeches in the *Furniss* case, especially those of Lord Scarman, Lord Roskill and Lord Bridge ... to the effect that the journey's end may not yet have been found.'

With the recent decisions of the House of Lords in *Barclays Mercantile Business Finance Limited v Mawson* and *CIR v Scottish Provident Institution* we are probably closer to the final destination.

Construing a taxing statute

The *Ramsay* principle has been applied in a number of situations; I consider, by

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planned: this was the upshot of the wafer-thin majority decision of the House of Lords in *Craven v White*.³

Thirdly, the *Ramsay* principle has been applied more recently to determine whether shares or a debenture should be respected: *Collector of Stamp Revenue v Arrowsmith Ltd*⁴ and *Carreras Group Ltd v Stamp Commissioner*.⁵ I will come back to these cases later in the article. (Whether this is a third category distinct from the second is not entirely clear. For example, in *Arrowsmith*, Lord Millet referred to the issue of the relevant shares as forming part of a larger transaction, and therefore falling squarely within the *Ramsay* principle. And *Carreras* can be seen as a relatively straightforward application of the *Ramsay* principle.)

In *Mawson*, however, the House of Lords has made it abundantly clear – along with a mild (and some would say unfair)

nature of the transaction to which it was intended to apply and then to decide whether the actual transaction (which might involve considering the overall effect of a number of elements intended to operate together) answers to the statutory description.

Although it may be a characteristic of many composite transactions that they may include elements inserted for no business or commercial reason, the consequence of this approach is that, depending on the circumstances, transactions or elements of transactions having no commercial purpose may still be respected for tax purposes.

Accordingly, it is wrong to say that there is a 'no business purpose test' that has always to be applied in construing taxing statutes – for that too would be falling into the same trap that we have been warned against.

The logical consequence of this approach is that Lord Hoffman's distinction, which he introduced in *MacNiven v Westmoreland Investments Ltd*,⁶ between commercial concepts (susceptible to the *Ramsay* doctrine) and legal concepts (immune from that doctrine) has been downplayed to 'not an unreasonable generalisation' and 'not intended as a substitute for a close analysis of what the statute means'. (Interestingly, Lord Walker, in his address given earlier this year to the Chancery Bar Association, considered this distinction to be a 'valuable and thought-provoking insight'.)

The key seems to be whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction viewed 'realistically'. This emphasis on the 'reality' of transactions is not new. As far back as 1982 Lord Fraser, in *IRC v Burmah Oil Co Ltd*,⁷ crystallised the question as being whether a 'real' loss was created. More recently, at

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way of the briefest of thumb-nail sketches, only three.

In *Ramsay* what was disregarded as a fiscal nullity was a 'circular self-cancelling scheme'. In this case an asset typically starts and ends up with the taxpayer.

Secondly, the *Ramsay* principle was then applied in *Furniss v Dawson* to what has been described as a 'linear' transaction. In this case an asset may start with the taxpayer but ends up at a different destination. *Ramsay* only applies to linear transactions where there is 'practical certainty' that the steps will proceed as

rebut to tax lawyers generally – that there is no special set of rules for interpreting taxing statutes. Accordingly, attempts to resolve tax questions by a delicate analysis of the *Ramsay* doctrine and the shoe-horning of facts into one or other of the three categories above, is probably a fruitless exercise.

Mawson tells us that the modern approach to statutory construction – which is to be applied to taxing and non-taxing statutes alike – is to give the statutory provision a purposive construction in order to determine the

first instance in *Mawson*, Park J accepted that in a strictly legal sense BMBF had incurred expenditure on the provision of the pipeline but that the question to be answered was on what did BMBF *really* (Park J's emphasis) incur its expenditure. In *Scottish Provident* the House of Lords referred to the purpose of the transaction being to create a tax loss not a 'real' loss or profit.

Mawson

In *Mawson* the House of Lords had to construe Capital Allowances Act 1990, s 24(1). The House decided that the relevant words were concerned entirely with the acts and purposes of the lessor, not with what happened to the purchase price paid by the lessor for the equipment.

In the light of that conclusion, and given that the Special Commissioners' finding that the transaction had no commercial reality was as a result of an examination of what happened to the purchase price, the House had little difficulty in finding for BMBF.

Scottish Provident

The question at issue was whether the Citibank option gave Citibank an 'entitlement' to gilts. Somewhat surprisingly there is very little analysis as to the purpose of the relevant statutory rules in order to determine the answer to that question. This may, however, have been because of the concession by Counsel for *Scottish Provident* that if there was 'no genuine commercial possibility' of the two options not being exercised together, the scheme must fail.

Instead we are told that the question of law was whether the existence of a commercially real possibility that the two options would not be exercised so as to cancel each other out meant that the two options were to be respected for tax purposes rather than treated as cancelling each other out.

Accordingly, the focus of the judgment is on the composite transaction doctrine and how the court could free itself from the constraints of *Craven v White*. In essence, the House decided that as the parties to the transaction had themselves built in a level of uncertainty for no commercial reason, and solely in order to defeat the application of the composite transaction doctrine, that uncertainty was to be ignored. The single composite transaction doctrine applied. The House thereby concluded that Citibank did not have an entitlement to gilts.

But it is arguable that this approach is precisely the one that *Mawson* tells us is



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not to be adopted – namely applying a special set of rules applicable to taxing provisions. Indeed the judgment looks like a 'classic' *Ramsay* judgment with one very important change, namely that tax advisers cannot be the ones to introduce the uncertainty.

Two other recent cases

In *Arrowsdown* and *Carreras* the relieving provision required an analysis as to whether a particular instrument should be respected; shares in the case of *Arrowsdown* and a debenture in the case of *Carreras*. In both of these cases the relevant instrument was, as a matter of law, issued. However, those instruments were ignored for tax purposes, essentially on the basis

purposes? The Special Commissioners in *Campbell v IRC*⁸ (in a judgment described by the House in *Mawson* as perceptive) thought so, and stated that if the shares either had realistic rights to dividends or capital, or if the shares had been issued for a commercial purpose, they would have been respected for stamp duty purposes. But how material would those rights need to be? A workable test – based on the issue of shares and nominal values – has been replaced by an uncertain test. (Moreover, there is additional uncertainty in that it is not entirely clear that *Arrowsdown* was correctly decided. The House of Lords in *Mawson* did not specifically approve *Arrowsdown*, quoting only a small part of the judgment of Ribeiro PJ.)

What rights attaching to the debenture in *Carreras* would have been sufficient? Presumably the mere fact that a debenture is to be repaid in cash was not of itself problematic! But what maturity date would have been adequate? One month, one year or five years? The answer is unclear. Again a workable test – based on whether a debenture has been issued – is replaced by an uncertain test.

Put and call options

How do the principles described in *Mawson* and *Scottish Provident* apply to the use of cross put and call options over shares? Paragraph 603 of the Inland Revenue Company Taxation Manual has a clear explanation of these arrangements:

'Cross options over shares, which are also known as "put and call" options, are in practical terms equivalent to an

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that, in the context of the relieving provision, the shares/debenture had to be issued for a commercial purpose.

The problem therefore was that the shares and debenture were not the right kind of shares or debenture. But how is it possible to work out what are the right kind of shares or debenture?

It is true that in *Arrowsdown* the relevant share rights were miniscule, but would the grafting of material rights onto those shares have been sufficient to render them the right type of shares for stamp duty

unconditional contract for sale. A cross option over shares occurs where:

'A can insist at some stage on buying B's shares; and

'B can insist on A buying B's shares.

But in law options over shares are different from an unconditional contract for sale. *J. Sainsbury PLC v O'Connor* 64 TC 208 shows that the existence of options does not affect beneficial ownership.'

Imagine that Company B wishes to sell a subsidiary (Target) to Company A. Company B wishes to have practical

certainty that the sale will proceed but does not want to lose beneficial ownership of the shares in Target before the actual sale, because, for example, Company B wishes to preserve a tax grouping with Target to enable a pre-sale reorganisation to be effected on a tax-free basis.

How should the options be structured? Company A and Company B therefore enter into cross put and call options over the shares in Target.

We know from *Mawson* that the fact that the options may be used only for tax purposes is not, of itself, sufficient to render them ineffective for those purposes.

Following *Scottish Provident*, is it necessary that there is a genuine commercial risk that neither of the options will be exercised? Is a racing certainty that one option will be exercised problematic? Is it necessary that there is a mismatch between the two options? Would a self-serving mismatch be effective for tax purposes? Does it matter which tax grouping is being considered? (Unlike in *Scottish Provident*, where the concern was that both call options would be exercised, with cross put and call options only one option will ever be exercised. It is doubtful, however, that this is a distinction of much importance.)

But are any of the above questions relevant? The real question to be asked here is whether Company B has 'beneficial ownership' of Target for the relevant tax grouping purpose – and there are very helpful comments in *Sainsbury* to the effect that (at least in the context of the group relief rules) Parliament did not intend the term beneficial ownership to have a special meaning (see, in

particular, the judgment of Nourse LJ at page 250B and D-E). Indeed it should not be forgotten that *Sainsbury* is itself an example of the use of cross put and call options designed to preserve a group relief group.

The residual concern remains, however, that the Inland Revenue could seek to argue – contrary to what it says in its Manual – that if the practical effect is that a sale is essentially guaranteed the legal effect (for tax purposes) is that Company B is treated as having entered into a contract to sell Target at a time when the options are granted and that Company B may therefore have lost beneficial ownership of Target from that time.

Conclusion

It is helpful that the House of Lords has reiterated that the real principle to be adopted is that the statute must be interpreted, the facts properly understood, and the statute applied to the facts.

However, there is a genuine concern that the House of Lords has, at a minimum, blunted some useful tools that at least provided a framework to help tax practitioners to make sense of tax rules and introduced a degree of certainty as to their application. It is not clear that those tools have been taken away entirely, as the traditional *Ramsay* analysis was deployed in *Scottish Provident* itself, and aspects of it in *Carreras* and *Arrowtown*.

Nevertheless, we are now told to look at the words of the relevant provision, the purpose of the provision, and the context in which it is being applied.

That is all well and good when the purpose of the rule is clear. But what if

that purpose is unclear? The concern is that, in these circumstances, the courts may forget the following words of Lord Hoffmann in *MacNiven* (at paragraph 62): 'The fact that steps taken for the avoidance of tax are acceptable or unacceptable is the conclusion at which one arrives by applying the statutory language to the facts of the case. It is not a test for deciding whether it applies or not.' It is considered that there is more than a hint of this forgetfulness in *Scottish Provident* – see, for example, the first sentence of paragraph 2 of the judgment: 'This appeal concerns an artificial scheme devised in 1995 to take advantage of a prospective change in the system of taxing gains on options to buy or sell bonds and government securities.' And it may be telling that the extract from Lord Wilberforce's speech in *Ramsay* cited in *Mawson* (at paragraph 29) omitted the two preceding sentences: 'A subject is only to be taxed on clear words, not on "intendment" or on the "equity" of an Act. Any taxing Act of Parliament is to be construed in accordance with this principle.'

We may be closer to the journey's end, but are we arriving at a desirable destination?

Notes

¹ [1984] STC 153 at 156.

² [1997] STC 908 at 921.

³ [1988] STC 476.

⁴ [2003] HKCFA 46.

⁵ [2004] STC 1377.

⁶ [2001] STC 237.

⁷ [1982] STC 30 at 38.

⁸ [2004] STC (SCD) 396.