Annual Lecture Melbourne 2007

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'Managing Tax Avoidance: Recent UK experience'

Thank you for inviting me. It is a great honour to be asked to give the third Annual lecture especially when I have two such eminent and 'assiduous' predecessors. I have read their slightly contrasting comments and will try to steer a middle course. The Ramsay case of 1981 will be my equivalent of Myer Emporium for Justice Young. I was much taken by Alan Myers' point that Chief Justice Barwick's attitudes could be traced back to the pre-WWII era of individualism soon to be overtaken in the wartime and post war eras by the need, constantly demonstrated in films and plays as well as judicial decisions, to pull together. I was wondering whether attitudes might swing back when I came across a report of a survey by the Henley Centre for Forecasting, a prestigious and independent body in the UK. This showed that, for the first time in 10 years, a majority now believed that the quality of life is best improved by putting the individual first. [1] The report notes that such individualism has its price; The Association of Graduate Recruiters found many candidates far too self centred to employ - more than half its members would fail to fill their vacancies this year.

It is a great pleasure to be back in Melbourne. My links began with Harold Ford and I spent two months here 1979. Since then I have tended to spend some of my sabbatical leave in North America not least in 1985—86 when I had the pleasure of being in Case Western Reserve University Law School in Cleveland, Ohio. I spent the year with Leon Gabinet, Erik Jensen and Karen Moore (now a Federal Judge) trying to make sense of the American materials which had just been cited enigmatically by the House of Lords in Furniss v Dawson (1984). The overwhelming message I came away with was that the US system with its doctrines such as form and substance, step transactions, economic substance and sham were all very well in their natural habitat but I was not at all sure that they would fit well in the UK where, it seemed to me, we place great emphasis on finding rules that were justiciable. As Lord Scarman said in Furniss v Dawson, "the determination of what does, and what does not, constitute unacceptable tax evasion is a subject suited to development by judicial process."

You will note that Lord Scarman uses the term 'evasion' rather than 'avoidance' thereby showing that he had not taken his basic course in taxation. However Lord Scarman was far

[1] 1997 when Mr Blair came to power 70% adopted a community first approach.

too great a judge - and classical scholar[2] - to have done that without thought and a revisiting of the terminology is overdue – but not this evening.

I presented these views in a series of articles in the British Tax Review which attracted interested comment from a variety of American scholars.[3] Some suggested that I had over dramatised the situation by presenting their doctrines as hard rules rather than as devices for use in interpreting statutes. I had not intended to do so but, as my purpose was precisely to prevent the House from turning them into hard rules, I should not complain. As it happened, the English courts did try to treat their own words as rules so my caution was justified .The articles formed part of the taxpayer's paperwork in *Craven v White* in 1988. Now in 2007 we have ended up with a situation not unlike the US in that we have now reduced our questions to ones of interpretation rather than hard rules. But that is simply clearing the decks for a new game. As I like to say, less chaos more uncertainty.

My, rather large, brief is to talk about how we manage avoidance in the UK, our judicial/legislative responses, including recent UK developments and our "rash" of anti-avoidance legislation. It includes my views on the approach of the House of Lords as compared, say, to the use of a GAAR or detailed legislation countering specific tax schemes. I must also cover the UK approach to notification or registration of tax schemes and the role of the tax advisor, given your own promoter penalties legislation. We shall look at the work of a new player in our fiscal legislative process, the House of Lords Select Committee on the Finance Bill. This committee brings the considerable financial expertise existing on all sides of the House to inform consideration of the Finance bill during its passage through Parliament. However it must not encroach on the financial privileges of the Commons and therefore does not address questions involving the rates or incidence of tax but focuses on technical matters of tax administration, clarification or simplification.[4]

My own attitude or, if I am on the European mainland my philosophy, is that I approve of what we call the Ramsay approach or the composite transaction doctrine (what to call it has been the cause of vexed and heated debate as we shall see later) and am hostile to avoidance schemes. I think they give rise to complex legislation and in turn there are increases in costs for everyone. It can also lead to a breakdown of trust between tax authorities and the taxed

[2] He was a classical scholar at Radley College and then Brasenose College Oxford where he obtained First class degrees in the two famous classical exams known as Mods and Greats.
[3] [1987] BTR 180 and 220 and [1988] BTR 63 and 108.
[4] 2003 House of Lords Paper 121-1 paras 7 –8

and such trust, if mutual, is important. Some of you may find this last point an odd, eccentric or even pernicious way of talking and wonder if I also believe in Father Christmas.

Let us turn to the facts of the Ramsay scheme, peddled in the 1970s, to you will see what I mean. *Ramsay* concerned CGT. A company (R) had a large gain (£187,977) and wished to create an allowable loss which could be set against the gain and so offset its liability for tax. R bought a scheme from advisers on terms which made the amount of the fee vary with the amount of tax saved. We now enter the fantasy land of tax planning. R bought shares in a company (C) and proceeded to make two, apparently long term, loans to C, each of £218,750 at 11% (a genuine commercial rate at that time) and repayable at par (i.e. £218,750) after 30 and 31 years respectively. C was entitled to make earlier repayment, if it wished to but was obliged to do so if it went into liquidation. If either loan were repaid before its maturity date, it had to be repaid at par or at its market value, whichever was the higher. As C did not have £437,500 lying around, it borrowed that sum from a bank associated with the scheme's vendors.

R had the right to decrease the rate of interest on one loan, on one occasion only, provided there was a corresponding increase on the other loan. R exercised the right causing the rate on one loan (L1) to drop to nil; this meant that the rate of interest on the other loan (L2) had to move in the opposite direction and by the same amount. So the interest rate on L2 rose to 22%, making it a significantly valuable asset, and L2 was sold by R for its market value price of £391,481, a gain of £172,731. Subsequently C paid off L1, at par as it was obliged to do. The very directly connected value of the shares in C dropped and the shares were sold by R at a large consequential loss (£175,731).

R argued that, while the loss on the shares should be recognized, the gain on the loan should not. This was because of a rule that a gain on a debt, as opposed to a debt on a security, should not be recognised. Accepting a new line of argument based on treating a series of transactions such as these as one composite transaction, the House decided there was no relevant loss for CGT purposes. The House was surely right. No system can tolerate a situation in which taxpayers up and down the country have a choice – to pay the Revenue or pay a tax adviser. The scheme failed in the Court of Appeal and in the House of Lords.

The approach of the House of Lords in Ramsay was a novel one – it was novel because this was the first time that the composite transaction point had been put to one of our courts; it was put by Peter Millett, QC, counsel for the Revenue. The members of the House were very conscious of the novelty of the point and Lord Wilberforce was at pains to point out that their

decision did not, in his view at least, undermine what he called ‘the cardinal principle’ of *Inland Revenue Comrs v Duke of Westminster* that where a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance. I think Lord Wilberforce is right on this – we must not undermine the cardinal principle but we can be a little more realistic in our approach to the facts. The *Westminster* case and others from that era are rightly taken as examples of a strict approach to the interpretation of tax legislation. That was the nature of the judicial approach in many other areas. Now in 2007 we no longer believe in a strict approach; we prefer a purposive approach. As was said in the *Barclays* decision in 2004,[5] the old strict approach went hand in hand with a very formalist approach to the facts and gave rise to an insistence on the part of the court on treating every transaction which had an individual legal identity as having its own separate tax consequences. So the courts were both literal and blinkered. Ramsay liberated the court from both these vices.

So the composite transaction approach enabled the court to find a modern real commercial characterisation of the facts. As Lord Wilberforce had said in 1981 the court’s task was to ascertain the legal nature of any transaction to which it was sought to attach a tax or a tax consequence and if that emerged from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.[6] This did not upset the cardinal principle set out above but enables the court to be less blinkered in deciding what the genuine transaction is.

The story by which we moved from Ramsay in 1981 to Barclays in 2004 forms the last – and longest - part of this lecture. It can be seen as a story of judicial development in the traditional common law way - of development followed by doubts, of advance followed by circumspection. While Lord Wilberforce did not treat the case as creating a judicial GAAR, it clearly had the potential to do so if further and wider arguments were advanced in later cases or if judges left things less tidily than he had done. Lord Wilberforce does not appear in the later cases – he retired soon afterwards but virtually all the later cases take his comments in Ramsay as their starting point. The story that does emerge of the way in which the various decisions were first of all argued by counsel and then how they were viewed by the various participants or, as we now have to call them, stakeholders reacted – by stakeholders I mean the lower courts, the legal and accounting professions and above all HMRC.

After *Barclays* in 2004 the question for HMRC is whether they will be content to accept that approach indicated by the judges. It is not an approach which will stop all instances of what

[5] 2004 UKHL 51 paras 28-32

HMRC now call ‘abuse’. They have been tempted to look again at a GAAR but I think the temptation is going to be resisted.

My feeling about this is that they are not yet willing to set up the sort of rulings system that practitioners think would be needed. The HMRC view of rulings in the context of a GAAR was spelt out by the department’s star witness before the House of Lords Committee last year "...I think there is a very significant issue that arises there: how sensible would it be to offer pre-transaction clearances for what were very clearly tax avoidance arrangements? Again, how sensible is it to offer arrangements like that which then enable planners to refine their product again and again and again, as we have seen with some of our existing clearance measures, until they have got something that they think works. So there are very difficult issues to be sorted out".[7]

These remarks are of course directed to issues of rulings and avoidance. Elsewhere some progress has been made. In November 2006 the Varney committee reviewed links with large businesses The Chancellor announced that he would implement the review in full; hence HMRC has now agreed to bring in advanced rulings.[8] However, as far as I can tell, it is not a general system. Its purpose is to give business certainty about the tax consequences of significant investments and corporate reorganisations. I note a) it is confined to business, b) it may be confined to large businesses, c) it is not aimed to pass judgment on Mr Hartnett’s avoidance schemes but only for those who provide clear plans for investment, reconstructions and reorganisation.[9]

Even without a GAAR, HMRC can still do much to counter perceived abuse. Over the 40 or so years I have been dealing with our tax system, we have not been short of provisions. Some narrow others broad, countering avoidance. Like you we have over the years had many provisions designed to shore up the income tax in response to court decisions or planning schemes that came to light. We pay various prices for all this highly prescriptive legislation; one price pointed out by Lord Hoffman, is that the courts are driven to a non-purposive approach even thought leads to holes in the net the Revenue have persuaded Parliament to

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[6] [1982] AC 300 at 322, [1981] STC 174 at 179 , 54 TC 101 at 184.
[7] Mr Hartnett said (Q 283) quoted in Report on Finance Bill 2006 para 62; Mr Hartnett is the Director General one of HMRC.
[8] HM Treasury Press Release 92/06 17 November 2006 Proposal 4.6 The Review itself is available via www.hmrc.gov.uk/largecompanies/reviewlinks-largebus.shtml
[9] One may contrast the treatment of big business with that meted out to two taxpayers in what is known as the Arctic Systems case, more formally Jones v Garnett [2005] EWCA Civ 1553 [2006] STC 283 CA.

enact.[10] throgu whioch literalism by such have pointed In recent years we have had a series of major reforms to our corporate tax base. Mercifully each set of provisions has its own code and perhaps not so mercifully for some, though in my view quite properly, each code has its own anti avoidance rule or TargatedAAR. Here is the one for our regime for Capital expenditure on Intangibles FA 2002 Sch 29 has 143 relatively easy-to-read paragraphs; para 111 reads

111—(1) Tax avoidance arrangements shall be disregarded in determining whether a debit or credit is to be brought into account under this Schedule or the amount of any such debit or credit.

(2) Arrangements are "tax avoidance arrangements" if their main object or one of their main objects is to enable a company—

(*a*) to obtain a debit under this Schedule to which it would not otherwise be entitled or of a greater amount than that to which it would otherwise be entitled, or

(*b*) to avoid having to bring a credit into account under this Schedule or to reduce the amount of any such credit.

(3) In this paragraph—

"arrangements" includes any scheme, agreement or understanding, whether or not legally enforceable; and

"brought into account" means brought into account for tax purposes.

You will find slightly longer ones in terms of unallowable purposes in our legislation on loan relationships, on derivative contracts which used to be called financial instruments and on manufactured payments.[11] We have similar provisions to try and counter capital loss schemes for corporation tax - and now to be extended beyond the corporate sector.[12] There is an interesting general rule in the tax credits legislation aimed at those who deprive themselves of income for the purpose of securing entitlement to tax credits.[13] 2005 saw many provisions dealing with avoidance involving financial arrangements.[14] As with many changes in 2005 and later, we shall be able to trace these back to the new information gathering power – the

[10] Hoffmann [2005] BTR 197 at 205.

[11] FA 1996 Sch 9 para 13 (last amended) 2006-7 version, FA 2002 Sch 26 paras 23 and 24 and FA 2004 s. 137

[12] TCGA 1992 s. 8 as amended by FA 2006 s. 69 ; further amendments promised in 2007.

[13] Tax Credits (Definition and Calculation of Income) Regs SI 2002/2006 para 15.

[14] F NO 2 A 2005 s. 39 and Sch 7

duty to notify. There is also a view that moving to an accounting based system of profit determination would reduce avoidance but that raises too many other issues.[15]

HMRC may also increase the price of abuse by retrospective or retroactive legislation. We had a spectacular example of this when we removed loss relief from commodity straddles with effect from a date two years earlier.[16] Today, such legislation is only used in clearly delineated circumstances and with clear warnings. For example the employment income tax rules, some will remember as Schedule E, were rewritten as part of the ongoing Rewrite programme in the ITEPA 2003. In an effort to prevent avoidance these had to be immediately revised by FA 2003. Although Revenue spokesmen were optimistically assuring everyone that they had foreseen all that was to be foreseen they were wrong. On 2nd December 2004 the Minister, informed by the schemes reported under the new rules, made a written statement to the House of Commons that new changes would take effect as from that date and that when she became aware of arrangements designed to frustrate the government intention that a proper amount of tax should be paid legislation would be introduced to close them down as from 2nd December 2004.[17] Anecdotal evidence suggest that this has had the hoped for effect.[18] We also sometime change the tax effects of transactions entered into in earlier years, most recently in our inheritance tax. This slightly different technique conforms to the words of Dickson J, the great Canadian judge, who once said “no one has a vested right to continuance of the law as it stood in the past.”[19]

In the hope of inducing changes in behaviour we have also found very senior officials from HMRC going into offices to talk with Boards of Directors in an effort to wean them off avoidance schemes. We have the usual corporate governance issues.

We also have a more aggressive stance from HMRC when investigating avoidance. As Chris Tailby now of HMRC but formerly one of our most distinguished private practitioners has written.[20]
“HMRC’s intention is to make avoidance risky for businesses to undertake. Our approach is to deploy our resources in the business areas where the risk to the tax base is greatest... [and]

[15] See generally Schoen 2005 Tax Taw Review (New York) 111 espt at 144
[16] FA 1978 now TA 1988 s. 399
[17] House of Commons 2 December 2004 col 46 WS
[18] Few schemes were notified after that date; Lexis Nexis Finance Act No 2 Handbook p. 71
[19] Gustafson Drilling (1964) Ltd v MNR [1971] 1 SCR 271 at 282-3, cited by Loomer 2006 BTR 64 at 67 Note that the retrospective FA 1978 provisions on losses were held compatible with our Convention on Human Rights, A B C and D Application 8531/79 and comment by Baker 2005 BTR 1

to take them out of the areas of lowest risk to leave business to concentrate on it core activities…..From the perspective of HMRC it is difficult to see how it will normally be in the best interest of the client to adopt an arrangement which only arguably escapes the damaging label 'abusive practice' and even then may not succeed in reducing tax liability… The top… professionals will advise their clients to put clear blue water between themselves and any arrangement that might even arguably be described as an abusive practice."[21]

Like you we have used the criminal law and have put tax advisers, even members of the Bar, in prison for the offence of conspiring to defraud the Revenue when they advised on schemes which failed.[22] Since 1st January 2001 we have had an offence of being knowingly concerned in the fraudulent evasion of income tax.[23]

Notification powers

It is time to talk, briefly, about our information powers.[24] We now have four separate regimes Direct taxes, stamp duties, VAT and National insurance.[25] The stamp duty rules apply if the property is not wholly residential and the applicable value is at least £5m.[26]

I will concentrate on the direct taxes. The rules require a promoter (P)[27] and sometimes the taxpayer (or client) to provide the Revenue with information about a) notifiable arrangements and b) proposals for notifiable arrangements.[28] For a scheme to be notifiable it must enable, or might be expected to enable, any person to obtain a tax advantage in relation to any tax so prescribed in relation to the arrangements. It is also necessary that the main benefit or one of

[20] Writing about Halifax plc v C and E Commrs Case C 255/02 206 STC 919

[21] The Tax Journal Issue 833 17 April 2006 4 at 6.

[22] See Tiley Revenue Law §4.5.3 and cases such as R v Charlton [1996] STC 1417. On Charlton see Cunningham Taxation 4 January 1996 p. 329 and, for particularly robust criticism, Venables 7 Offshoe Taxation Ereview 1.

[23] FA 2000 s. 144 punishable on summary conviction, to imprisonment for a term not exceeding six months or a fine not exceeding the statutory maximum, or both; on conviction on indictment, to imprisonment for a term not exceeding seven years or a fine, or both.

[24] I am indebted to Rachel Tooma's article in Journal of Australasian tax teachers association 2006 vol 2 N0 1 158-177

[25] One scope of HMRC powers re direct taxes see S 318(1) 'tax'.

[26] Stamp Duty Land Tax (Prescribed Description of arrangements) Regulations 2005 SI 2005/1868

[27] Defined s 307.

[28] Defined s 306.

the main benefits that might be expected to arise from the arrangements is the obtaining of that advantage. There is protection for legal privilege.[29]

Is the tax advantage a 'main benefit?' HMRC Guidance say (Note para 5.2 make the following general points) 'In our experience those who plan tax arrangements fully understand the tax advantage such schemes are intended to achieve. Therefore we expect it will be obvious (with or without detailed explanation) to any potential client what they are buying and the relationship between the tax advantage and any other financial benefits. The test is objective and considers the value of the expected tax advantage compared to the value of any other benefits likely to be enjoyed.'

In the direct tax area the obligation to notify generally falls upon the promoter of the scheme. It falls on the user of the scheme if the promoter is resident outside the UK and no promoter is resident within the UK. [30] If there is no promoter, (i.e. the scheme is designed "in house"), the duty to notify falls on those entering into any transaction which is part of the notifiable arrangements.[31] The same applies where the promoter is prevented by legal professional privilege (LPP) from making a full disclosure.[32]

P must inform the Revenue when the notifiable proposal is made available for implementation or, if earlier, when P becomes aware of any transaction forming part of the proposed arrangements.[33] P does not have to notify the Revenue if someone else has already done so.[34] Once the Board have been informed, they may give the arrangements a reference number while further provisions deal with the obligations of promoters and parties to pass the number around.[35] The normal time limits by which a promoter must disclose a scheme are within 5 days of first making the scheme available for implementation or within 5 days of first becoming aware of a transaction implementing the scheme, whichever is the earlier.

[29] S 314; on scope of legal advice privilege see *Three Rivers District Council v Bank of England* [2005] UKHL 48. S 314 is reinforced by the Tax Avoidance Schemes (Promoters and Prescribed Circumstances) Regulations 2004, para 6 added by SI 2004/2613.

[30] S 309.

[31] S 310.

[32] SI 2004/1864 reg 4 (5A)

[33] On multiple promoters and multiple proposals see 308(4) and (5).

[34] S 308(3).

[35] Ss 311–13.

Those who fail to comply with a statutory obligation to disclose a scheme - or to advise client of a scheme reference number issued by HMRC - are liable to penalties. Our approach is different from yours – we want compliance. There is an initial fine (£5,000) and then a daily fine (£600) until the failure is remedied.

How well are they working? In 2006 the House of Lords Select Committee were pleased to note a broad consensus among witnesses from the private sector that the rules are working well, in particular by excluding unnecessary disclosures. "Setting up the necessary reviewing machinery has created more work for tax professionals and the burden is ultimately passed on to their clients in costs. *However, judged by the results described to us by HMT and HMRC, we concluded that this compliance burden was proportionate and justified by the outcome in terms of reducing the tax gap"*.

At the risk of appearing a touch cynical what this shows is that the sort of people who provide evidence to House of Lords Committees are generally content. Before we let all this go to our heads we should note that the Committee has so far considered only the scheme as enacted in 2004. In that first flush they were aimed just at certain types of arrangements connected with employment especially employment related securities and with financial products. There were also conditions or hallmarks with regard to premium fees and confidentiality.[36]

What were the 2004 rules trying to do? They were designed to improve transparency in the system and to enable the Revenue Departments to counter "sophisticated and aggressive avoidance schemes [that] thrive on concealment and secrecy". They were "aimed at those marketing and using certain tax avoidance schemes and arrangements [and] will allow early detection of such schemes and enable more effective targeting of avoiders". Our rules are not aimed at mass marketed schemes – we go wider than that. What they were after was not direct blocking, though that might follow, but speed of response. (During the 1970s, in the Ramsay era, it was often a condition of buying a scheme that claims for the relevant relief should be delayed until the last possible moment). By 2004 it was apparent that the Revenue needed to know about schemes earlier.[37]As we saw earlier in relation to employment related securities this has been achieved.

[36] SI 2004/1863 Regs 5A and 8 (now repealed)
[37] For comment see Fraser [2004] *BTR* 282–96 and 451–59.

The 2006 scheme widens the net for direct taxes.[38] The obligation to notify now arises not where there are those two types of arrangement but with any arrangements when there are 'hallmarks'. The HMRC Guidance includes a useful flowchart.[39] In theory a person can implement a scheme within the time frame but there is no evidence that HMRC are concerned about this - at present. The hallmarks include tests such as confidentiality, a premium fee, the presence of off market terms and being a standardised tax product. There are also distinct hallmarks for schemes involving losses and, separately, leases. Most apply for income tax, capital gains tax, corporation tax and NICs. Unfortunately one has to dig through each rule to find that in most cases they do not apply to small and medium size enterprises defined in EC law terms, Commission Recommendation of 6th May 2003 and that only rarely do they apply to individuals.

One fear was that there would be too many returns; another that there would be too few. So how many have there been? The statistics are released every six months 30th September and 30th March. The figures to the end of September 2006 showed that in the first two months of the new hallmark regime 34 schemes were notified. The very provisional total reported came to 1,143 of which Financial provided 451, employment 198 and SDLT 560; the total for hallmarks was 34. Who provided those returns? Big Four 353; other accounting 194; Legal 434; Financial Institutions and others 166. Most (399 /434) of the disclosures by legal practices related to SDLT.[40]

So how about there being too few? The new Finance Bill will contain clauses improving the scheme. At present the Revenue are limited in what they can do to investigate non-compliance. There are rumoured to be two penalty cases pending but what the department wants is earlier information. As the department admitted in their note of the 2006 consultation disclosure is, for the moment, effectively a self regulatory regime.[41] Non-compliance not only undermines the purpose of the disclosure regime (to provide early information about avoidance schemes), it also creates distortions and puts those promoters who comply at a competitive disadvantage.

[38] 2006/1543Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006

[39] Guidance on Disclosure of Tax Avoidance Schemes HMRC June 2006 (Available on HRMC website) p. 18

[40] Lakshmi Narain Tax Adviser September 206 p. 4

[41] See footnote 42.

How do HMRC find out? They monitor disclosures received and developments in the market place for tax schemes through published material, intelligence received and feedback from promoters. They also increasingly obtain evidence from enquiries into the tax returns of companies and individuals who have used schemes. [42]

Some defaulters tell HMRC nothing more than that they have systems in place to identify whether or not their products are notifiable and that they are satisfied that the particular scheme is not. Such promoters will generally refer to Counsel's opinion they hold that the scheme is not notifiable, but do not explain why the scheme is not notifiable. The proposed new rules are designed to resolve disputes about what is notifiable. They may well include a power to get more information and a pre-disclosure enquiry to help HMRC get clearer reasons why P thinks the scheme is not notifiable. Where there is a doubt about notifiability there may be a procedure by which HMRC can ask the Tribunal to order that scheme be treated as if it were notifiable – you can imagine the problems of the burden of proof here. Even more dramatically, where there is such a doubt, there may be a procedure by which HMRC can ask the Tribunal to determine that the scheme is notifiable. [43]

The GAAR.[44]

We have known GAARs in the excess profits taxation rules introduced for the First and Second World Wars.[45] Similar powers were part of profits tax[46] and the special charge in 1967.[47]

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[42] HMRC notes to draft clauses Pre Budget Report 6 December 2006: If HMRC obtains information that indicates a notifiable scheme may not have been disclosed, the normal practice is for HMRC to approach the promoter and invite explanation as to why the scheme has not been disclosed. Some promoters have provided explanations. Others tell HMRC nothing more that they have systems in place to identify whether or not their products are notifiable and that they are satisfied the particular scheme is not. Such promoters will generally refer to Counsel's opinion they hold that the scheme is not notifiable, but do not explain why the scheme is not notifiable.

[43] The proposed clauses are 308A, 313A, 306A and 314A.

[44] On history see Ridd in Studies the History of Tax law ed Tiley Hart Publishing first volume (2004) chapter 5 and volume II (2007) 7 Chapter 5; he comments FA 1941, s 35 etc and the decision in *Crown Bedding Co Ltd v IRC* [1946] 1 All ER 452; 34 TC 107 (CA) at pp. 168-174 .

[45] Ridd in Studies the History of Tax law ed Tiley Hart Publishing first volume (2004) chapter 5 and volume II (2007) 7 Chapter 5; he on comments FA 1941, s 35 etc and the decision in *Crown Bedding Co Ltd v IRC* [1946] 1 All ER 452; 34 TC 107 (CA) at pp. 168-174.

[46] FA 1951, s 32; see [1964] *BTR* 129.

However, the impetus for the GAAR was provided in the 1990s by the Institute for Fiscal Studies, our leading tax research organisation and a fiercely independent one. Under the chairmanship of Graham Aaronson, QC, the Institute's Tax Law Review Committee produced a report which, without actually recommending a General Anti Avoidance Rule (or GAAR) suggested that a GAAR with proper safeguards might well be preferable to then uncertain state of case-law and explored what a GAAR should look like if it was to be acceptable;[48] it looked at a number of other countries including your own.[49] The Committee recommended first that specific avoidance provisions should continue to be used. As to a GAAR it set out certain elements and safeguards.

The TLRC GAAR had several elements. In broad terms it was a purpose clause to deter or counteract transactions designed to avoid tax in a way which conflicted with or defeated the evident intention of Parliament. The basic rule which contrasted a 'tax-driven' transaction with a normal transaction; a person was to be taxed in accordance with the normal transaction. Where, because the tax-driven transaction does not have a non-tax objective and so there is no normal transaction, tax was to be charged as if it had not taken place. Among the safeguards was the notion of a protected transaction to which the rule would not apply. An annual report would be made to Parliament giving full details of the operation of the rule.

The tax elite of the nation had worked on the IFS report so the Revenue had to consider it; they produced a consultative document with its own clause. [50] Opinion within the Revenue was divided. Opinion in the profession - outside the 'elite' - was almost completely hostile. In turn the TLRC were severely critical of the Revenue's proposal.[51] The truth is probably that the scheme would have worked only with a proper system of rulings. The government was not willing to pay the financial costs of such a system, nor was it willing to pay the political cost of trying to force such a system onto taxpayers.

As we have seen earlier the rejection of a GAAR has not stopped the extensive use of provisions based on 'avoidance' and each major amendment to the tax base, usually

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[47] FA 1968, s 50.
[48] Tax Avoidance A Report by the Tax Law Review Committee IFS November 1997, the draft is in Appendix II.
[49] Chapter 3 and Appendix 1
[50] Inland Revenue General Anti Avoidance Rule for Direct Taxes, A Consultative Document October 1998
[51] TLRC Response to IR's Consultative Document (IFS, February 1999).

corporation tax, has contained it own mini GAAR in the form of unallowable purpose test—and without the protection of a statutory advance rulings system.[52]

Since 1997 the Chancellor and the Paymaster have often said that they did not plan to bring forward a GAAR but, as it was in their thoughts, HMRC are carrying out a legal study of these sorts of rules around the world. Indications are that HMRC accept that the rules produced very mixed results. [53] Having read Alan Myers address I do not think I need say more.

My view of the GAAR is that I regard it as a confession of failure. Moreover it may be too late. Recent - and so far unpublished - work done at the IFS TLRC reviewed the Finance Acts from 1998 to 2006. Of almost 200 changes in the law reviewed very few would be dealt with better by a GAAR. More specifically, it was difficult to see how a GAAR could deal with avoidance structured around specific rules and definitions.

With all the activity, legislative and administrative, and with an objective of what HMRC would see as raising the level of taxpayer behaviour by informal means, it is not the right time to make the dramatic and politically demanding switch to a GAAR. I have to acknowledge that in so far as this activity is legislative, the effects on the length of our statute book have been dire. Some see a GAAR as a way of shortening the statue book. You can tell me whether it has that effect here. I believe we can do at least as well - and probably better - with our existing approach especially as it seems to mesh in well with our schedular approach to the definition of income. We have neither a general definition of income nor a general system of deductions and we are systematically mean on loss reliefs across the schedules.

It is time to return to the story is what our judges have been up to. We left *Ramsay (*1981) as it had been expounded in *Barclays* (2005) "The modern approach to statutory construction is to have regard to the purpose of the particular provision and interpret its language, so far as possible, in a way which best gives effect to that purpose. Until the *Ramsay* case, however, revenue statutes were 'remarkably resistant' to the new non-formalist methods of interpretation. The particular vice of formalism in this area of law was the insistence of the

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[52] FA 1996 Sch 9 para 13, (Loan Relationships and since 2002 foreign exchange), FA 2002 Sch 26 para 23 (Derivatives) Sch 29 para 111 (Intellectual Property) FA 2004 s 137 adding TA 1988 Sch 23A para 7A (Manufactured Overseas Dividends) and FA 2004 s 38 inserting a new TA 1988 s 75 (Management Expenses) noting especially s 75(5); see also the reasons for removing annual payments from the category of charges on income in Finance Bill 2005 clause 132 and (Inland Revenue Notes).

[53] Para 58

courts on treating every transaction which had an individual legal identity (such as a payment of money, transfer of property, creation of debt etc) as having, its own separate tax consequence, whatever might be the terms of the statute. The *Ramsay* case liberated the construction of revenue statutes from being both literal and blinkered….Unfortunately, the novelty for tax lawyers of this exposure to ordinary principles of statutory construction produced a tendency to regard *Ramsay* as establishing a new jurisprudence governed by special rules of its own.

This tendency, the House acknowledged had been encouraged by two features characteristic of tax law. "The first is that tax is generally imposed by reference to economic activities or transactions which exist as Lord Wilberforce said 'in the real world'. The second it that a great deal of intellectual effort is devoted to structuring transaction in a form which will have the same or nearly the same economic effect as a taxable transaction but which it is hoped will fall outside the terms of the taxing statute."

It is to the story of the 'special rules' that we now turn. In the era of 1936, strict construction and a blinkered view of the facts, the view was that the Duke of Westminster was right and, probably, more than right – it was proper. The 1970s with high income tax rates (in 1978 the top rate was 98%)[54] and a rather unsatisfactory capital gains tax, saw the advent of marketed avoidance schemes. The Revenue continued to argue in traditional ways and so lost cases such as IRC v Plummer[55] or got the right answer by a slightly strained construction as in Floor v Davis [56] where the House divided 3-2 with Diplock and Wilberforce on opposite sides

As we saw 1981 brought the House's decision in Ramsay v IRC [57] the facts of which involved an artificial, circular, self cancelling transaction; was there a chargeable gain or allowable loss? At the risk of quoting something very familiar to you I repeat Templeman LJ's classic analysis in the Court of Appeal. [58]

"The facts as set out in the case stated by the Special Commissioners demonstrate yet another circular game in which the taxpayer and a few hired performers act out a play; nothing happens save that the Houdini taxpayer appears to escape from the manacles of tax.

[54] Made up of a top rate of 83% plus the investment income surcharge of 15%.
[55] [1979] STC 793
[56] [1979] STC 379
[57] [1981] STC 174; [1982] AC 300; 54 TC 101
[58] CA not HL [1979] STC 582.

The game is recognisable by four rules. First, the play is devised and scripted prior to performance. Secondly, real money and real documents are circulated and exchanged. Thirdly, the money is returned by the end of the performance. Fourthly, the financial position of the actors is the same at the end as it was in the beginning save that the taxpayer in the course of the performance pays the hired actors for their services. The object of the performance is to create the illusion that something has happened, that Hamlet has been killed and that Bottom did don an asses head so that tax advantages can be claimed as if something had happened.
The audience are informed that the actors reserve the right to walk out in the middle of the performance but in fact they are the creatures of the consultant who has sold and the taxpayer who has bought the play; the actors are never in a position to make a profit and there is no chance that they will go on strike. The critics are mistakenly informed that the play is based on a classic masterpiece called 'The Duke of Westminster' but in that piece the old retainer entered the theatre with his salary and left with a genuine entitlement to his salary and to an additional annuity."

After Ramsay in the House of Lords we had to ask ourselves what the House had done. Lord Wilberforce concluded that nothing the House was doing upset the cardinal principle about substance and form. However it was not clear what the House would do next. The fact that we can now say post *Barclays* in 2004 that it was all a question of construction does not alter that fact that at the time very different views were held. Was the House just adopting a realistic up-to-date approach to questions of fact and law or, was it a watershed case, like *Donoghue v Stevenson*, rewriting the law and creating at least the opportunity for the development of a judicial GAAR? If the latter, what hedging doctrines or limits would the court develop? If it was less than a GAAR and more like a step transaction doctrine, when was it to be applied? Always or selectively? If selectively, then on what basis? Life was uncertain – and, for an academic at least, great fun. For others things were more serious. What should the Revenue do with their success?

1982 brought the decision in *Burmah Oil*. The UK corporate reorganisation rules did not have a business purpose requirement until FA 1978. In *Burmah Oil* the House was dealing with facts which occurred before that act came into force HL. With Lord Diplock to the fore, they used Ramsay to prevent a company from using corporate reorganisation rules to turn worthless debt into worthless equity. There was little guidance on doctrine; just that Ramsay has changed the judicial approach. The only distinction from *Ramsay* – in eyes of judges - was that here the scheme was tailor-made for Burmah not mass-produced and that was not enough of a distinction. The important thing was that Ramsay was applied, possibly without

too much thought, to a normal corporate planning provision being used by a major taxpayer with very respectable advisers. [59] It is probably right to view it as a circular transaction - like Ramsay

And so to 1984 and the high point, Furniss v Dawson ,[60] another corporate reorganisation case dealing with pre 1978 facts but this time clearly a linear transaction. D, a shareholder wished to sell his stake in a company (OpCo) to another company (Wood Bastow or WB). He went to respectable solicitors and, as a result, implemented a straightforward plan, the effect of which would be to defer payment of tax until he was ready to receive the proceeds. D first exchanged his shares in OpCo for shares in another company (Greenjacket or GJ), a company resident in the Isle of Man). GJ then sold the shares in OpCo to WB. This left D holding shares in GJ and the money paid by WB still sitting in GJ – so D had not yet got his hands on the cash but could do so by liquidating GJ or, but less likely, causing GJ to pay a dividend.

Using hypothetical numbers, we now need to see what is going on. Suppose D's shares in Op Co had a base cost of £1 and the sale to WB was going to be at £4. If D had simply sold the shares to WB, D would have had a capital gain of £3. Under the scheme D exchanged shares in OpCo for shares in GJ. Provided that the court is satisfied that D had fulfilled the terms of the corporate reorganisation rules for share-for-share exchanges, D would then be treated as acquiring the shares in GJ not at £4 but at his base cost for the original shareholding being exchanged - £1 – so that there would be no gain at this time. GJ would not be liable to tax on any gain as it was non-resident and so, under our rather self denying rules, not subject to UK tax on any gain. If in the fullness of time D sold the shares in GJ D would pay tax on the gain of £3 – i.e. £4 price less base cost of £1. So D was really doing deferring his liability to tax –

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[59] Thus Lord Diplock "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 transaction (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, 19 TC 490 at 520, '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."

unless he did anything else in the meantime - like dying or, probably less painfully, going to reside in another jurisdiction. It is important to note that D had not liquidated GJ- that would have been caught by *Floor v Davis*.[61]

I regard Furniss v Dawson as a classic problem of determining the ratio of the case – especially as Lord Brightman was quite determined to make it difficult.

The passage which is always quoted begins with denying a distinction: "… [T]he rationale of the new approach is this. 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 like series of steps which are followed through because the participants are contractually bound to take each step seriatim…... *Ramsay* says that the fiscal result is to be no different if the several steps are preordained rather than pre-contracted."

So *Ramsay* is an approach to schemes whose steps are 'preordained' rather than contractually binding. Then we have 'the rule', taken from Lord Diplock in *Burmah,* who had expressed what Lord Brightman called the limitations of the *Ramsay* principle. "First, there must be a preordained series of transactions; or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end. The composite transaction does, in the instant case; it achieved a sale of the shares in the operating companies by the taxpayers to Wood Bastow. It did not in *Ramsay*. Secondly, there must be steps inserted which have no commercial (business) *purpose* apart from the avoidance of a liability to tax—not 'no business *effect*'. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied."

In the instant case the inserted step was the introduction of Greenjacket as a buyer from the taxpayers and as a seller to Wood Bastow. That inserted step had no business purpose apart from the deferment of tax, although it had a business effect.

What do we make of these as words? What was going on? Were they creating a judicial GAAR? Or simply applying the words of the legislation? Can we make the later cases consistent with this formulation? As with *Ramsay* ,but even more so, The judges in *Furniss v*

[60] [1984] STC 153; [1984] AC 474; 55 TC 324

Dawson were very anxious to stress that it was still early in the *Ramsay* era and all seemed content with the lack of intellectual infrastructure or any rigour. The court had applied the composite transaction doctrine in a linear transaction which was main stream stock of tax practice. Was its doctrine – assuming that it is the right word to use - to be applied in all statutory contexts or only in some The court did not seem to mind about the practical uncertainty. It was not clear what arguments the Revenue were going to produce next and the House were not going to pre-empt things.

Today in 2007, with our new understanding that it is all a question of interpretation, that there is no doctrine or rule, just an approach, things seem different. The difference is shown by one of my favourite paragraphs. It comes from the speech of Lord Nicholls in the *MacNiven* case (2001). Anticipating what he was to say in the *Barclays* case in 2004, Lord Nicholls came down decisively in favour of this simply applying the words of the legislation. I will quote it and comment (with interpolations and emphasis) as I go.

"[8] My Lords, I readily accept that the factual situation described by Lord Brightman is one where, typically, the *Ramsay* approach will be a valuable aid (just a valuable aid, and if so to what?). In such a situation, when ascertaining the legal nature of the transaction and then relating this to the statute, application of the *Ramsay* approach may well have the effect stated by Lord Brightman. **But, as I am sure Lord Brightman would be the first to acknowledge**, the *Ramsay* approach is no more than a useful aid (CRUX). This is not an area for absolutes (MORE CRUX). The paramount question always is one of interpretation of the particular statutory provision and its application to the facts of the case.

I am not convinced that Lord Brightman would have made that acknowledgment but I think he would not have rejected it either. It was far more likely that he would have said that it was too early to say.

But Lord Nicholls pushes his argument further. "As I have sought to explain, *Ramsay* did not introduce a new legal principle. (AND SO) It would be wrong, therefore, to set bounds to the circumstances in which the *Ramsay* approach may be appropriate and helpful (NO HEDGING DEVICES NEEDED). The need to consider a document or transaction in its proper context, and the need to adopt a purposive approach when construing taxation legislation, is principles of general application." You can decide whether it is breathtakingly brilliant or brilliantly breathtaking.

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[61] 1979 STC 379

That is all very well but let us be practical - how should the Revenue have carried out their legal duty to collect tax in accordance with the law? Thankfully – for us - they carefully arranged for three appeals to be heard together in 1988. Of the panel of five hearing the appeal, none had sat in the earlier cases at House of Lords level. 1988 answered resolved the question whether it was a GAAR or a more confined composite (or preordained) transaction doctrine – (IT WAS NOT) and, by a majority, gave a very narrow interpretation to when transactions were preordained – the 'no practical likelihood' test.

It may be best to mention *Bayliss v Gregory* first.[62] Here the House looked at another corporate reorganisation like *Furniss v Dawson.* However, here the share for share exchange was not followed by a consummation of the later steps. In fact, the company was sold on to a quite different purchaser on quite different terms some 18 months later. This did not affect the fact that the original share for share exchange had been tax driven. The House of Lords held, unanimously and without effort, first that the tax avoidance purpose was not enough to invalidate the exchange[63] and secondly that the eventual sale to someone else did not fit the composite transaction test.

Craven v White was more difficult; the House split 3-2. Once more there was a share for share exchange with an Isle of Man company. This time though the sale *did* go through to the intended purchaser but only just. At the time of the share exchange (11 July) the prospects for the sale to O did not look promising and an alternative disposal was considered. However, on the same day, O asked for a further meeting. The Commissioners had held that the primary objective of the share exchange was the sale to O and that the taxpayer was keeping its options open. Following further negotiations, including one "stormy meeting", the sale to O finally went through on 9 August of the same year. This time the House of Lords said "no", but by a bare majority.

The majority consisted of Lord Oliver and the two Scottish law lords – Keith and Jauncey. Lord Oliver refers to a series of transactions preordained in order to produce a given result and there being at that time no practical likelihood that the pre-planned events would not take place in the order ordained; in such circumstances the intermediate transaction was not even

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[62] 1988] STC 476; [1989] AC 398

[63] Among many matters which troubled the House, as they had troubled the Court of Appeal, was what the legal status of the first transaction would be while one waited to see what might

contemplated practically as having an independent life.[64] Lord Templeman and Lord Goff dissented – they would have said the steps made one transaction. The majority view is current orthodoxy. As Lord Nicholls put in the *Scottish Provident* case in late 2004 "…There was an uncertainty about whether the alleged composite transaction would proceed to completion which arose, not from the terms of the alleged composite transaction itself, but from the fact that, at the relevant date, no composite transaction had yet been put together."[65]

Sadly, I must pass by cases in which the House required that the rearrangement for which the Revenue contended should make sense.[66] Even more sadly I pass by *IRC v Moodie* [67] the House faced with identical facts to those in *IRC v Plummer*[68], just before Ramsay, proceeded to apply the Ramsay approach to reach a different conclusion. Lord Hoffmann's name appears in this case but as the first instance judge Lord Hoffman thought he could apply *Ramsay*; the Court of Appeal thought he was wrong. I gloss over the interesting 1992 non recourse financing capital allowance case of *Ensign Tankers Leasing Ltd v Stokes* [69]I do so reluctantly because there is a particularly masterful speech by Lord Goff.

We move fast forward to late 1997, *IRC v McGuckian* .[70] The importance of this case lies first in the way in which Lord Steyn and Lord Cooke in particular traced *Ramsay* as an example of purposive construction – and which Lord Nicholls referred to in *Barclays*. From their words it appeared that a court could reach a judgment in favour of the Revenue without using the composite transaction approach just by a purposive construction. So this left construction as leading to yet wider powers in the court – and to arguments by HMRC - to counteract avoidance.

In the late 1990s I appeared in a debate with Graham Aaronson. You will recall that the IFS Report's case for a GAAR was driven by his critique of the case law. We can perhaps more clearly the nature and depth of his unhappiness. For him, relying on case law was unsatisfactory first because, as compared with a GAAR, it was retrospective (like all court

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ensue, and, in particular, the status of any assessments to tax which might have been made on the basis of that first transaction (as might have occurred in the *Bowater* case).

[64] At 514, 507, 203.

[65] Paras 21 and 22.

[66] Fitzwilliam v IRC [1993] STC 502

[67] [1993] STC 188

[68] [1979] STC 793

[69] [1992] STC 226 HL 1992 1 AC 655

[70] [1997] STC 907

decisions);[71] secondly, the judicial doctrine was too restrictive (in its insistence on having a preordained transaction and a tightly drawn sense of "preordained"); thirdly, it was arbitrary (in that when it applies it simply knocked out steps). It was also insufficiently targeted as one could not rely on judges to carve out the IFS GAAR's notion of a 'protected' transaction). Other epithets he used were hypocritical and unprincipled (by falsely presenting itself as a matter of simple interpretation when it was actually a matter of complex application); and uncontrolled (through the lack of any clearance procedure).

And so to 2001 and the new Millennium. Just when we had got our minds round the widening approach in *McGuckian* - and the Revenue were wondering how to make use of it - the Revenue invited the House to adopt a strong version of the composite transaction doctrine.[72] They came unstuck. First, the House rejected the strong doctrine.[73] Then, they held that even a weak version of the doctrine was not going to get the Revenue home.

In *Westmorland Investments v MacNiven* ,[74] it was agreed that the composite transaction doctrine was a question of interpretation (or application). However the judges held that the logically prior question - was the provision was one to which the composite transaction doctrine could apply? - was itself to be a question of construction. So even though they had

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[71] E.g. *Moodie* v *IRC* [1993] STC 188 where the House of Lords decision reversed its own earlier decision in *Plummer* v *IRC*[1980] AC 896 [1978] STC 793; on the scheme see Gillard In the Name of Charity, Chatto and Windus London 1987 chapter 3.

[72] It is set out in Lord Hoffmann's speech para 28 'When a Court is asked

> (i) to apply a statutory provision on which a taxpayer relies for the sake of establishing some tax advantage (ii) in circumstances where the transaction which is said to give rise to the tax advantage is, or forms part of, some pre-ordained, circular, self-cancelling transaction (iii) which transaction though accepted as perfectly genuine (ie not impeached as a sham) was undertaken for no commercial purpose other than the obtaining of the tax advantage in question
>
> then (unless there is something in the statutory provisions concerned to indicate that this rule should not be applied) there is a rule of construction that the condition laid down in the statute for the obtaining of the tax advantage has not been satisfied.'

[73] So Lord Hoffmann at para 29 My Lords, I am bound to say that this does not look to me like a principle of construction at all…. Mr McCall's formulation looks like an overriding legal principle, superimposed upon the whole of revenue law without regard to the language or purpose of any particular provision, save for the possibility of rebuttal by language which can be brought within his final parenthesis.

[74] [2001] STC 237

proved that it was 'practically certain' that the various steps would succeed each other, the Revenue might still lose. In what may have begun with points made in argument but became the centrepiece of Lord Hoffmann's speech, with which the other judges expressly agreed though adding points of their own, Lord Hoffmann drew his celebrated –or notorious - distinction between concepts which were commercial (where the doctrine was useful) and those which were legal or juristic where there was no reason to use the test. The (vigorous) dissenting speech which Lord Templeman would have given if he had not retired is published in 117 LQR 565.

Westmoreland (WIL) was a property company that owed £70m including £40m arrears of interest on loans from a pension fund; the pension fund was its only shareholder. If the interest could be **paid**, WIL would be able at that time, thanks to TA 1988 s. 338, to use that payment as a charge on income so creating a loss which could be set against profits the company might earn in later years, even, subject to TA 1988 s. 768, profits earned following a change of ownership. The scheme enabled this payment to be made.[75] The pension fund shareholders lent the money to WIL, which passed it back as a payment of interest. The facts thus disclosed a preordained series of transactions carried out in order to secure a payment of interest and a tax advantage in that WIL now had an allowable loss. Lord Hoffmann held that the term payment was to be construed juristically as opposed to commercially. In this case, the juristic meaning was that there was a payment if the legal obligation to pay interest had been discharged. It followed that there was no room for the Revenue's broadly formulated principle.

Of the other members of the committee – Lords Nicholls, Hobhouse, Hope and Hutton – only Lord Hobhouse gave a simple concurrence. If you actually want to understand the case however you need to look at Lord Nicholls speech.

He confessed that his initial view, which remained unchanged for some time, was that a payment comprising a circular flow of cash between borrower and lender, made for no commercial purpose other than gaining a tax advantage, would not constitute payment within the meaning of s 338. However eventually he concluded that in deciding whether a debt had been paid one shod not worry how that had come about. Once that was accepted, he did not see it could matter that there was no business purpose other than gaining a tax advantage. A genuine discharge of a genuine debt could not cease to qualify as a payment for the purpose

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[75] It is a nice question whether the problem would not arise under the Loan relationship rules in FA 1996. If the connected party rules apply the deduction would be given only if, as in the present case, the interest was actually paid.

of s 338 by reason only that it was made solely to secure a tax advantage. He also noted that what was upsetting the Revenue was the ability of the pension scheme trustees to reclaim the tax deducted by WIL from the payments. That was the consequence of the tax exempt status of the pension scheme. For him the concept of payment in s 338(3) (a) could not vary according to the tax status of the person to whom the interest is owed.

There is no time to rehearse criticisms hurled at Lord Hoffmann's distinction[76] but simply to record that from 2001 to the end of 2004 everyone involved in these affairs solemnly did exactly what Lord Hoffmann may have asked them to do which was first to identify the concept then ask whether it was commercial or legal and then apply the answer to the facts. Such an intellectual straitjacket was rejected by the House in *Barclays*.[77] I do not doubt the sincerity with which Lord Hoffmann floated the distinction but experience showed that it was not workable; the classification was hard to apply and there is the prior problem of identifying the particular concept which was to be classified.[78]

And so to 2004 and two decisions, *Barclays and Scottish Provident. Barclays Mercantile Business Finance Lt d v Mawson* [79] is the case which stripped out the excrescences which had come to mar what Lord Wilberforce had begun and gives us our new beginning. The courts will not develop a wide ranging GAAR – they have no power to do so. They will scrutinise legislation purposively and interpret words in context. This is a matter of approach not of bright line rules. So they will apply the composite transaction doctrine selectively – but not irrationally. What reasons will they give? What reasons will work? We do not know. This is why *Barclays* is not the end, there never can be an end to Lord Scarman's role, but a new beginning.

An Irish company, "BGE", had built a pipeline. They sold the pipeline to the taxpayers, "BMBF", for £91.3m. BMBF leased the assets back to BGE which granted a sub-lease onwards to its UK subsidiary. The question was whether BMBF was entitled to a capital allowance in respect of the £91.3m spent, as BMBF argued, to acquire an asset used in its business of finance leasing. The simple finance deal was then hedged around with many complex money flows; BMBF argued that the purpose of these arrangements was to ensure that the sums due from BGE under the lease arrangements would actually come through. In

[76] For criticism of Lord Hoffmann's distinction see Mr Justice Ribeiro PJ in *Arrowtown* para 40 and Lord Millet in paras 148 –151 citing the problems expressed by the Court of Appeal in *Barclays* by Peter Gibson LJ para 44 and Carnwath LJ 69 and 73.
[77] Para 32 such an intellectual striatjacjet was to be avoided
[78] See Barclays CA above.
[79] [2005] STC 1

the Chancery Division Park J said that the underlying purpose of Parliament in relation to finance leasing, had been to enable capital allowances to be used so as to provide finance to lessees at attractive rates for them to use and to develop their real business activities. So it was not to enable cash payments to be made annually to third parties who were able to provide a major item of machinery or plant which satisfies one of the conditions for a finance lessor to claim the allowances. That was not in accordance with 'the purpose and spirit of the legislation'. [80] The Court of Appeal – and the House of Lords – could find no warrant for so restricted a view.

Barclays was a very determined effort to clean the law up. Once Park J's analysis of the purpose of the legislation was rejected Barclays were going to win. However it does end the quest; it marks a new beginning. We are back with Lord Scarman's assertion that the determination of what does, and what does not, constitute unacceptable tax [avoidance] is a subject suited to development by judicial process.

My last case is the other 2004 House of Lords case *Scottish Provident* where the House unanimously gave a slightly wider effect   to the composite transaction doctrine. A company had entered into what was clearly a composite transaction with the rule. The parties had then added a term which had the effect that there was now a chance that the rights would not be exercised. As it happened the rights were exercised. The chances of the relevant event, a price movement, was the Special Commissioners held, like an outsider winning a horse race. The House held that the Special Commissioners had erred in law in concluding that because there was a realistic possibility of the options not being exercised simultaneously, therefore the scheme could not be regarded as a single composite transaction.[81]

So at para 23 "[23] We think that it would destroy the value of the *Ramsay* principle if their composite effect had to be disregarded simply because the parties had deliberately included a commercially irrelevant contingency, creating an acceptable risk that the scheme might not work as planned. We would be back in the world of artificial tax schemes, now equipped with anti-*Ramsay* devices. The composite effect of such a scheme should be considered as it was intended to operate and without regard to the possibility that, contrary to the intention and expectations of the parties; it might not work as planned."

And so to Conclusions

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[80] Para 51
[81] italics supplied

Notification regime working well; there is, in my view, no need as yet for a GAAR unless one can simplify the principles or in some areas to create them. Nothing is going to stop the drive of legislation from year to year or the endless and quite justified efforts on the part of HMRC to identify and police the areas of abuse.

While the story of the cases may not emerge smoothly and inevitably, it does represent a marvellous example of what courts can do. I have watched all the twists and turns and even participated in some. My views has been that *Ramsay* approach is or at least should be one of statutory interpretation and application and so Lord Nicholls and his colleagues have held. One can trace a coherent thread through - but only if one chooses the right thread. It also illustrates Lord Goff's famous statement in his British Academy Maccabean Lecture on Jurisprudence that the common law develops pragmatically on a case by case basis. He also said, quoting a German student, that in the common law system, unlike the civil law, it was the judge, not the professor, who is God. Where the courts go next will depend on which issues are argued and what arguments are used. I think the judges come out of this tolerably well. They have presented their thoughts in wonderful prose sprinkled with occacasional irony. They have quite often allowed themselves to become fixated with phrases – and so everyone else has had to too – but they have ended up in a position which is intellectually - and constitutionally – sustainable. It is however a situation in which, as Lord Nicholls, said there will be differences of opinion; that is the nature of issues of interpretation. They have reached a situation which meets some but not all of Graham Aaronson's criticisms.

Where they or the system do not come out of it well is in relation to the American authorities. Lord Wilberforce asked for these – and some Australian ones – in *Ramsay*. They were also cited in *Furniss v Dawson* in 1984. I have not seen what was submitted to the court but the results are not impressive. In *Craven v White* in 1988 the panel simply told counsel for the Revenue that there was no need for him to taken them on his proposed word tour.

Now that we have a rule which does not need 'limitations' or hedging devices it may be time to take a closer look at the American experience. They have developed at least three tests of interdependence for their step transaction doctrine; some may be worth looking at. We do not need to be trapped by the strictness of the practical certainty test in those situations where the approach can be used. As Lord Nicholls has told us it is all a matter of interpretation and so anything can be considered. What we need is for someone to do the work so that counsel can inform the court.