The Personal Tax Planning Review

DO NOT PASS GO ...

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Introduction

The recent decision in *Hurlingham Estates Ltd v Wilde*[3] illustrates the dangers of undertaking or advising upon a transaction without giving proper consideration to the taxation issues. In that case as part of a larger transaction relating to the disposal of a business the parties granted a lease for less than 50 years at a premium without taking into account the potential liability to the landlord to taxation upon an appropriate part of the premium as income.[4] It was held that the solicitor involved was in the circumstances of the case expected to advise upon the taxation issues arising and that his failure to do so was a breach of professional duty. The judge drew attention to the risks of venturing into a transaction without understanding the surrounding taxation problems; he stated:[5]

> "He entered the tax minefield armed only with a precedent book ... not knowing what to look for or the significance of anything he found."

As regards the duty of a professional adviser in such circumstances, he stated:[6]

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3 [1997] STC 627.

4 Pursuant to Income and Corporation Taxes Act 1988 section 34.

5 [1997] SAC 627 at 632.

6 [1997] SAC 627 at 634.

> "I would expect any reasonably competent solicitor practising in the field of conveyancing or commercial law to be aware of the concealed trap for the unwary"

Whether the particular adviser's duties extended as far as tax advice depended upon the terms of his retainer.

The converse may also be a problem and a potential consequence of the decision would appear to be that persons who regularly advise upon particular areas of tax may be expected to understand and be prepared to explain the related law of trusts or wills or company law.

In the experience of the writers' in many cases the interaction of taxation planning and company law is not given adequate attention and many transactions have encountered or could encounter difficulties where the tax planning may have been immaculate but the underlying company law has not been given sufficient attention,[7] although on occasion company law has been beneficial to the tax planning.[8] The potential dangers of company law interfering with personal tax planning have recently been highlighted by the decision in *Parlett v Gruppys*,[9] although in that case tax planning does not appear to have been a driving consideration.

In that case the plaintiff was a director of various associated companies[10] including the defendant company. As part of the resolution of a family dispute regarding the various companies it was agreed that, in return for his transferring his holding of shares in one of the company ("Estates") into the joint names of himself and his sons, all of the companies, including, the defendant company and Estates, would pay him a annual salary of £100,000 plus a bonus equal to 25% of the net profits of the various relevant

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7 See, for example, the suggestion that the transactions at other than market value were *ultra vires* in *Ridge Securities Ltd v I.C.* [1964] 3 All ER 1108 or possessed a different legal character; *Petrotim Securities Ltd v Ayres* [1964] 1 All ER 269; but note the same judge's second thoughts on the *ultra vires* issue in *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62 and see also the comments in *Re: Halt Garage (1964) Ltd* [1982] 3 All ER 1076 on whether these types of case were really concerned with dividends and improper exercises of their powers by the board of directors.

8 See, for example, *Shearer v Bercain* [1980] STC 359 on share premium accounts, but this has now been revised - see Companies Act 1985 sections 131 and 132.

9 [1996] 2 BCLC 34.

10 It may be an important factor that companies which were parties to the agreement in question were not members of a group because then in certain variations of the situation there might have been a question of subsidiary companies providing financial assistance in relation to the acquisition of shares in their parent company which is also prohibited.

companies and, on his retirement, a pension. All of the companies agreed to share the costs of the salary, bonus payment and the pension in the most tax efficient manner. Following his retirement several years later he handed a blank stock transfer form for the shares in Estates to his sons who nominated the defendant company as the transferee.[11] The plaintiff claimed various sums owing to him pursuant to the earlier agreement. This claim was resisted on the basis that it involved Estates providing unlawful financial assistance resulting in a depletion of its net assets in connection with the transfer of its shares. It was held, following the unreported decision in *Lawlor v Gray*,[12] that notwithstanding that Estates was a party to the agreement, it was possible to execute the arrangements without falling foul of section 151 of the Companies Act 1985. Since the agreement provided for the relevant payments to be made by any of the companies, Estates was not necessarily committed to make any part of the payments. On the facts, therefore, there was no unlawful arrangement.

However, the decision appears to turn upon its own facts and there are certain interesting comments which suggest that in the appropriate circumstances there would be the commission of an offence. For example, it was stated *inter alia* that:

> the salary and bonus arrangements represented sums that exceeded the value of the benefit of the services to be supplied by the plaintiff to the various companies[13] and so involved a depletion of their net assets[14] which may represent unlawful financial assistance;[15]
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> the fact that the plaintiff was an employee did not, of itself, prevent the arrangement from involving a potential payment in breach of section 151 of the Companies Act 1985;[16] and
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> the fact that the salary and bonus payments were to be made only if there were sufficient profits did not mean that there would not be any reduction or any

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11 It should be noted that certain dealings in blank stock transfer forms are unlawful pursuant to Finance Act 1963 section 67 but no issue appears to have arisen on this provision in this case.

12 [1997] CA Transcript 409.

13 On the company law issue of "excessive" remuneration of directors and "disguised distributions", see *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1076.

14 [1996] 2 BCLC 34 at page 43 to 44.

15 See Companies Act 1985 section 151(1)(a)(iv); note the comments in *Charterhouse Investment Trust Ltd v Tempest Diesel Ltd* [1986] BCLC 1.

16 [1996] 2 BCLC 34 at 46e.

material reduction in the net assets of the Estates.[17]

The case is, therefore, a clear warning that the allocation of payments to a seller of shares in his capacity as a director or employee of the target company and to be made by that company could involve the commission of an offence pursuant to section 151 of the Companies Act 1985.

The issues of unlawful financial assistance and/or payments to or for the benefit of vendor shareholders, albeit in their capacity as directors or employees, may arise in less obvious circumstances. For example, the arrangements for the repayment of debts owed by the target company or its subsidiary companies to the vendors may fall foul of these prohibitions,[18] as arrangements for the release of guarantees given by the vendors of shares in respect of debts or liabilities of target company.

The company law interface

As can be see from the above summary of the facts of *Parlett v Gruppys*,[19] the case was not, as such, concerned with taxation but it clearly highlights the potential problems of situations where, for example, a shareholder who is also a director of the company is proposing to dispose of shares in that company. Given the changes in the taxation structure over recent Finance Acts there are situations now where there may be a better post-tax result[20] for a vendor in not taking the whole of the consideration by way of sale proceeds. In many situations, notwithstanding Schedule 7 to the Finance Act 1997 and the further changes in the Finance (No.2) Act 1997, there may be benefits for certain types of taxpayers who are selling a company to take, in effect, part of the sale proceeds by way of a pre-sale divided[21] and to take a reduced sale price for the

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17 There is also a suggestion in the judgment that it would not have been possible to save the transaction had it been unlawful by seeking to implement the "whitewash" procedure in Companies Act 1985 section 155.

18 See, for example, the discussion in *Armour Hicks Northern Ltd v Whitehouse* [1980] 1 WLR 1520; a case decided upon earlier legislation and which is not entirely satisfactory because it was merely deciding whether there was an arguable point upon a preliminary hearing.

19 [1996] 2 BCLC 34.

20 On the question of whether the power of choice based upon the post-tax position is tax avoidance, see *I.C. v Willoughby* [1997] STC 995; *I.C. v Kleinwort Benson Ltd* [1969] 2 All ER 757; R S Nock `Tax Avoidance' in Shipwright (ed) *Tax Avoidance and the Law.*

21 On the drafting of the clause in this type of situation where, as is usual, the purchaser may be required to fund the target company which may have had to borrow the money in order to pay the dividend, see *Spectros International v Madden* [1997] STC 114; the borrowing of money in order to pay a dividend is a lawful activity: see *Brown v I.C.* 47 TC 217.

shares.[22]

Taxation planning

Other techniques intended to mitigate the tax charge potentially arising upon the sale of the share capital in a company may be tried from time to time, such as the payments being received by the vendor in his capacity of director in some form. For example, it might be considered that there could be tax savings by the director receiving some form of compensation for loss of office or golden handshake.[23] Such an arrangement is likely to be regarded as provocative by the Inland Revenue who may quite easily disallow the payments as not being a trading expense as far as the target company is concerned. Thus in *Snook v Blasdale*[24] it was provided in an agreement for the sale of the share capital of the company that the purchaser would procure that the company would pay compensation for loss of office to those directors and the auditor of the company who were to resign. It was held that the compensation payments were not deductible by the company. The tax prohibition is, however, not total; the judge stated:[25]

> "The mere circumstance that compensation to retiring directors is paid on a change of shareholding control does not of itself involve the consequence that such compensation can never be a deductible trading expense. So much is common ground. But it is essential in such cases that the Company should prove to the Commissioners' satisfaction that it considered the question of payment wholly untrammelled by the terms of the bargain its shareholders had struck with those who were to buy their shares and came to a decision to pay solely in the interests of its trade.
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> This may be very difficult at times, because the persons who have to take the

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22 This may have certain stamp duty advantages for the purchaser since, *prima facie*, that purchaser will be paying a lower price for the shares but for many years the Stamp Office have from time to time taken a point similar to that in *Spectros International v Madden* [1997] STC 114 and sought to contend that the undertaking by the purchaser to procure the repayment of the indebtedness of the target company is part of the stampable consideration; see Monroe & Nock, *The Law of Stamp Duties* 7th edition paragraphs 3-65 footnote 17.

23 Income and Corporation Taxes Act 1988 sections 148 and 188.

24 (1952) 33 TC 244; see also *Peters & Co Ltd v Smith* (1963) 41 TC 264 and *George J Smith v Furlong* (1969) 45 TC 384.

25 (1952) 33 TC 244 at 251; see also *Over v Ashford Dunn & Co Ltd* (1933) 17 TC 497 and; *Basset Enterprises Ltd v Petty* (1938) 21 TC 750.

> decision are often the persons who are to get the compensation; but any difficulty in securing an independent decision by or on behalf of the Company does not do anyway with the necessity of securing it if entitlement to deduct the compensation as a trade expense is to be sought. Evidence proving such a decision is wholly lacking here: so that the Commissioners had before them evidence establishing that payment of compensation was one of the terms of the bargain for the purchase and sale of the shares and no evidence that the Company considered the matter independently and decided to pay the compensation solely to advance its own trading interests. In those circumstances the Commissioners found that the compensation was not paid wholly and exclusively for the purposes of the Company's trade. That decision is one of fact; there is evidence to support it; and therefore I cannot interfere with it."

Alternatively, it may be thought that it might be more tax efficient to make some form of additional payment by way of "super bonus" to the director or even as some form of "signing on fee" or "golden handcuffs"[26] as an inducement to the director to stay, since these have, on occasion, been tax free but this may lack credibility where he already has a service contract; or as a payment of consideration for a restrictive covenant[27] either in favour of the target company or for the purchaser[28] and paid to him as shareholder.

Other variations on the theme will include payments for restrictive covenants or arrangements under which the shareholder, albeit as director, undertakes not to carry on a competing business. It is clear from cases such as *Connors v Connors Bros Ltd*[29] that where a person buys shares in a company it is not unreasonable to extract some form of undertaking from the sellers not to carry on a business competing with that carried on by the target company.[30] This is a element of protecting the goodwill notwithstanding that the purchaser is acquiring the corporate vehicle which is carrying on the trade and so owns the goodwill. The payment for the restrictive covenant may

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26 See, for example, *Jarrold v Boustead* (1964) 41 TC 705; *Riley v Coglan* (1967) 44 TC 481; *Pritchard v Arundale* (1971) 47 TC 680; *Glantre Engineering Ltd v Goodhand* (1982) 56 TC 165; *Shilton v Wilmhurst* [1991] STC 88.

27 See, for example, *Higgs v Olivier* (1951) 33 TC 136 and Income and Corporation Taxes Act 1988 section 313; Finance Act 1988 section 73.

28 On the legality of payments to vendors of shares for agreements not to compete with the target company, see *Connors v Connors* [1940] 4 All ER 179.

29 [1940] 4 All ER 179.

30 See *Kirby v Thorn EMI* [1987] STC 61.

take the form of the company protecting its own goodwill by making a suitable compensation payment upon the termination of the service contract of the director or employee or a payment by the purchaser to the vendors of the shares.[31]

Price allocation

Obviously, in such situations, there must be some genuine "goodwill" that is being protected and the price determined accordingly.[32] It must not be overlooked that although in *Re Brown and Root MacDermotts Fabricators Limited's application*[33] the judge held that for stamp duty purposes[34] the Stamp Office could not go behind or challenge a price allocation made in good faith on a particular basis, in cases such as *Saunders v Edwards*[35] the Court of Appeal has indicated that where a price is allocated between assets not upon a *bona fide* basis but with a view to producing a particular tax result that has nothing to do with the values of the interests concerned, this may amount to a criminal offence involving forgery and/or fraud upon the Inland Revenue; and it has been said that it is professional misconduct of the party's advisors to co-operate in

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31 On the taxation of such receipts in the hands of employees or vendors, see Income and Corporation Taxes Act 1988 section 313.

32 There are, however, many other factors to be considered in the allocation of the price between the assets and, in particular, the recognition of goodwill. For example, the giving of a restrictive covenant is for stamp duty purposes potentially the transfer of goodwill (see *Eastern National Omnibus Ltd v I.C.* [1938] 3 All ER 526). If the price is allocated to the shares the stamp duty will be at the lowest rate of 50p per £100 or part thereof of the consideration, whereas a sale of goodwill will attract stamp duty at the rate of 2% the consideration therefore exceeds the £500,000 threshold. The purchaser may be required to write off the cost of the "goodwill" against profits or reserves pursuant to Companies Act 1985 Schedule 4 paragraph 21 and FRS 10, which could have an adverse effect on the share value of the purchaser through its effect upon dividend yield, earnings per share and other factors influencing financial commentators upon the valuation of shares. In some situations connected with the disposal and acquisition of industrial know-how the purchaser may be entitled to capital allowances where the parties elect to treat the transaction as involving know-how rather than goodwill and the purchaser will receive tax recognition for the acquisition cost only upon the ultimate disposal of the asset, whereas from the point of view of the vendor a disposal of know-how may involve an immediate balancing charge under the capital allowances regime; but the capital gain arising upon the disposal of goodwill may be capable of roll-over pursuant to the relief for the replacement of business assets (see Income and Corporation Taxes Act 1988 section 530; Taxation of Chargeable Gains Act 1992 section 152 and following).

33 [1996] SAC 483.

34 See Stamp Act 1891 section 58.

35 [1987] 2 All ER 615.

such arrangements.[36] There must, therefore, be some real commercial justification for the existence of the so called "goodwill"[37] that requires to be protected by the restrictive covenant.[38]

However, in addition to the problems of the company seeking to obtain a deduction for this type of payment in computing its corporation tax there will now be the question that has to be faced as to whether such payments are unlawful financial assistance within the terms of section 151 of the Companies Act 1985. Certain types of payment may escape since some of these, such as pre-sale dividends, are specifically excluded from the realm of unlawful financial assistance. Thus, for example, in those cases where the company cannot pay a divided as a matter of company law and the parties are seeking to generate some form of "distribution" for tax purposes within section 209(2)(b) of the Income and Corporation Taxes Act 1988 by means of some form of share buy-back. this is not unlawful financial assistance;[39] but the drafting of the documents may be important.[40]

However, where the exclusion provisions are not appropriate to make the arrangements lawful then it is very difficult to justify, particularly in the light of the assumptions that appear to have been made in *Parlett v Gruppys*[41] that a super bonus payment or an increase in salary to a director who is already under a long-term service contract and there is no need for the company to make the payment is an attempt to reduce the

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36 Note also the comments in the Court of Appeal in *Lloyds and Scottish Finance Ltd v Prentice* (1977) 121 Sol Jo 847 on the improper allocation of the price as a basis for using certificates of value; (not relevant on appeal to House of Lords, see [1992] BCLC 609).

37 In the absence of "goodwill", i.e. a relevant business, the restrictive covenant may be void -on covenants in gross see, for example, *Vancouver Malt and Sake Brewing v Vancouver Breweries* [1934] AC 181.

38 On restrictive covenants as a sale of goodwill see, for example, *Eastern National Omnibus v I.C.* [1938] 3 All ER 526.

39 Except, perhaps, in the case of an unlimited company. Such companies have very wide power of returning capital to members (see Table E (1985) Article 4(e)) but the return of capital by unlimited companies is not specifically mentioned in the exclusions from section 151 of the Companies Act 1985. This raises the question as to whether such a return of capital by an unlimited company to a selling shareholder is not unlawful financial assistance on general principle because of the unlimited nature of the company or whether there has been an oversight in the drafting of the relieving provisions and that a return of capital in connection with a sale of its shares by an unlimited company is unlawful financial assistance. Whilst the point is arguable, the sanctions attached to a wrong view are potentially severe.

40 See, for example, *Sectors International plc v Madden* [1997] SAC 114.

41 [1996] 2 BCLC 34.

purchase price for the sale of the shares. It might be said that the purpose of the exercise is to reduce the price and to assist the seller by providing a more tax efficient method of disposing of the shares, but the transaction also has the effect of reducing the purchase price to the purchaser; it seems that one can assist a vendor as much as a purchaser and an attempt to put cash in the hands of the vendor by means of some gratuitous arrangement by the target company is quite capable of constituting unlawful financial assistance.

The fact that the planning is based around taxation mitigation does not appear to operate as a defence, notwithstanding that sections 151 and following of the Companies Act 1985 provide that the unlawful financial assistance provisions are not to apply where there is a larger purpose and any financial assistance is purely incidental to that larger purpose. However, it was clearly stated by the House of Lords in *Brady v Brady*[42] that this must be a purpose of the company and not a purpose of the shareholders. Lord Oliver gave the relieving provision a very limited area of application when he said:[43]

> " ... para (a) is contemplating two alterative situations. The first envisages a principal and, by implication, a subsidiary purpose. The inquiry here is whether the assistance given was principally in order to relieve the purchaser of shares in the company of his indebtedness resulting from the acquisition or whether it was principally for some other purpose, for instance the acquisition from the purchaser of some asset which the company requires for its business. That is the situation envisaged by Buckley LJ in the course of his judgment in the *Belmont Finance* case as giving rise to doubts ... The alterative situation is where it is not suggested that the financial assistance was intended to achieve any other object than the reduction or discharge of the indebtedness but where that result (i.e. the reduction or discharge) is merely incidental to some larger purpose of the company. Those last three words are important. What has to be sought is some larger overall corporate purpose in which the resultant reduction or discharge is merely incidental ... My Lords, I confess that I have not found the concept of a 'larger purpose' easy to grasp, but if the paragraph is to be given any meaning that does not in effect provide a blank cheque for avoiding the effective application of s.151 in every case, the concept must be narrower than that for which the appellants contend ...
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> ... there has always to be borne in mind the mischief against which s.151 is aimed. In particular, if the section is not, effectively, to be deprived of any useful application, it is important to distinguish between a purpose and the

42 [1988] 2 All ER 617.

43 [1988 2 All ER 617 at 632.

> reason why a purpose is formed. The ultimate reason for forming the purpose of financing an acquisition may, and in most cases probably will, be more important to those making the decision than the immediate transaction itself. But 'larger' is not the same thing as 'more important' nor is 'reason' the same as 'purpose' ... The purpose and the only purpose of the financial assistance is and remains that of enabling the shares to be acquired and the financial or commercial advantages following from the acquisition, whilst they may form the reason for forming the purpose of providing assistance, are a by-product of it rather than independent purpose of which the assistance can properly be considered to be an incident ...".

Therefore, to the extent that the transaction is intended to assist or benefit the shareholders, the larger purpose exemption would not apply.

Tax planning as unlawful financial assistance

The question of taxation planning arose in relation to an earlier provision[44] on unlawful financial assistance in *Charterhouse Investment v Tempest Diesels Ltd.*[45] Under the system of group relief[46] whereby one company in a suitably structured group or consortium arrangement which has certain types of losses or excess expenditure may make the loss available to another member of the group of companies which is making relevant profits, the loss so transferred or surrendered can be used by the transferee company to reduce the profits subject to tax, thereby reducing the overall taxation liability of the group. Since the surrender of a loss may have the effect of increasing the taxation liability of the surrendering company when it returns to profit in later years it is provided that the company to which the loss is surrendered may make a compensatory payment to the company making the surrender.[47] This compensation payment is tax neutral in that it is not a chargeable receipt to the surrendering company and is not tax deductible to the paying company, provided that the amount of the payment does not exceed the amount of the loss. Whether to make a payment and, subject to the maximum permitted sum, the amount of the payment, are discretionary so that a company may pay nothing or the full amount of the actual losses; it is not restricted to the benefit received, namely the amount of tax which it saves.

This system of group relief, together with the flexibility of the amount of compensation

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44 Companies Act 1984 section 54.

45 [1986] BCC 1.

46 See Income and Corporation Taxes Act 1988 sections 402 and following.

47 Income and Corporation Taxes Act 1988 section 402(6).

payment, offers a number of opportunities for extracting value from a subsidiary company in a tax efficient manner. For example, where a parent company has made a loss a surrender to a subsidiary company for a sum equal to the amount of the loss surrendered has effectively extracted in a tax free fashion a sum equal to the differences between the amount paid and the tax saved at the current tax rate on the subsidiary company's profits. Similarly, where a subsidiary company surrender a loss to its parent company for no compensatory payment it has effectively made a transfer to its parent company of the amount of the tax saved. The decision in *Charterhouse Investment Trust Ltd v Tempest Diesels Ltd*[48] raises the question of whether these or other tax planning arrangements associated with the sale of a company are unlawful.

In that case the subsidiary company ("Tempest") was trading at a loss. The parent company ("Charterhouse") entered into negotiations for the sale of Tempest. It was agreed with the purchaser that, in effect, the balance sheet of Tempest would be tidied up, which involved, *inter alia*, the injection of new share capital by Charterhouse which was to be utilised in repaying part of the debts owed by Tempest to associated companies. The purchaser would make a loan to Tempest in order to enable it to repay part of the balance of the loan remaining outstanding; Tempest would give various restrictive covenants to Charterhouse, certain indebtedness of Tempest was to be released. Subject thereto, the shares in Tempest were sold to the purchaser for £1.[49] Subsequently it was alleged that certain surrenders of trading losses by Tempest to other members of the group were part of these arrangements, and being associated with the sale of its shares, were unlawful financial assistance within the provisions then in force, namely section 54 of the Companies Act 1948 (which differs in certain respects from section 151 but the concepts are not fundamentally different). It was held that, on the facts of the case, because there was not a transfer of assets which reduced the price that the purchaser would pay as compared with the price that would have been paid had the transaction not been entered into, there was no infringement of the said section 54.n

Certain comments of the learned judge, Hoffmann J, as he then was, appear to have relevance in relation to the risks of transactions being unlawful financial assistance when connected with share sales.[50] Even if the transaction is at full value there may

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48 [1986] BCC 1.

49 It appears that certain of these arrangements were affected by the desire of the vendor to obtain an allowable capital loss on the disposal of the shares in Tempest - see [1986] BCC 1 at 4f-g.

50 See also *Brady v Brady* [1988] 2 All ER 617 and *Plant v Steiner* [1989] 5 BCC 352 on issues of unlawful financial assistance connected with reorganisations of companies which would appear to have relevance to pre-sale restructuring exercises.

be a problem, since it was stated:[51]

> "The *Belmont* case shows that the sale of an asset by the company at a fair value can properly be described as giving financial assistance if the effect is to provide the purchaser of its shares with the cash needed to pay for them. It does not matter that the company's balance sheet is undisturbed in the sense that the cash paid out is replaced by an asset of equivalent value. In the case of a loan by a company to a creditworthy purchaser of its shares, the balance sheet is equally undisturbed but the loan plainly constitutes giving financial assistance. It follows that if the only or main purpose of such a transaction is to enable the purchaser to buy the shares, the section is contravened. But the *Belmont* case is of limited assistance in deciding whether or not an altogether different transaction amounts to giving financial assistance.
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> The need to look at the commercial realities means that one cannot consider the surrender letter in isolation. Although it constitute a collateral contract, it was in truth part of a composite transaction under which Tempest both received benefits and assumed burdens. It is necessary to look at this transaction as a whole and decide whether it constituted the giving of financial assistance by Tempest. This must involve a determination of where the net balance of financial advantage lay. I see no contradiction between this view and anything which was said in the *Belmont* case. In *Belmont* the company made cash available to the purchaser.[52] This amounted to giving financial assistance and no less so because it was done without any net transfer of value by the company. On the facts of this case there is no question of cash being provided and the only way in which it can even plausibly be suggested that Tempest gave financial assistance is if it made a net transfer of value which reduced the price Mr Allam [the purchaser] would have had to pay for the shares if the transaction as a whole had not taken place."

More helpful is the comment, albeit *obiter*, at the end of the judgment. Having found that there was no real depletion in assets, Hoffmann J stated:[53]

> "This conclusion makes it unnecessary for me to decide what the position would have been if the transaction had involved a net transfer of value from Tempest to the Charterhouse Group. I say only that I am not satisfied that

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51 [1986] BCC 1 at 10.

52 On the problems raised by this approach and the new "larger purposes" defence, see the comments of Lord Oliver in *Brady v Brady* [1988] 2 All ER 632.

53 [1986] BCLC 1 at 14c.

> even if it were, Tempest could be said to have given financial assistance. The object of the transaction was to put the assets and liabilities of Tempest into a state in which it was acceptable to both parties for them to be sold to Mr Allam [the purchaser] for £1. If this process involved the prior extraction by the shareholders of assets from Tempest by means which were *intra vires* and not a fraud upon creditors, I doubt whether it could be described in any acceptable commercial sense as a giving of financial assistance by the company. It is no more than a change in the character of the assets being sold."

That was a case concerning what would perhaps now be described as a management buy-out of a subsidiary company and, as part of the arrangements, certain trading losses were surrendered.

Whilst on the facts of the case the learned Judge held that there was not unlawful financial assistance, this was a question of fact and not a matter of principle, and the result might differ in similar circumstances. In other words, there was no suggestion that simply because the transaction is part of some taxation planning exercise it cannot be unlawful financial assistance.[54]

No doubt everything will depend upon the circumstances of any particular case and if the payment can be justified, for example as being a proper assessment of a compensation payment to the director who is being removed from office, then there is no financial assistance since the company will need to meet its obligations. However, spontaneous generosity in the form of bonus payments may well be vulnerable, particularly in those cases where there is no consistent pattern of the company paying a large proportion of its profits by way of bonus payments to its directors or employees.[55] The novelty of the situation emphasises that the payment is in connection with the disposal of shares.

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54 Even where the arrangement does not fall within Companies Act 1985 section 151 it may nevertheless be improper or unlawful for other reasons, such as breach of directors' duty or an unlawful dividend; see, for example, on over-generous payments to directors, *Re Halt Garage (1964) Ltd* [1982] 3 All ER 1076; on pension contributions see, for example, *Dracup v Dakin* (1957) 37 TC 377; the decision in *Re W and M Roith Ltd* [1967] 1 All ER 427 is probably now incorrect on the issue of *ultra vires* but the question remains whether the improper purpose of benefiting the employees rather than promoting the business of the company may mean that the case was correctly decided but should have been based upon breach of duty by the board of directors - see *Rolled Steel Products Holdings Ltd v British Steel Corporation* [1985] 3 All ER 1.

55 Compare the recent decision of the Special Commissioner on the exemption from inheritance tax for gifts made out of income of a normal and reasonable nature in *Nadin v I.C.* [1997] Special Commissioners Decision 0112.

The whitewash procedure

It is, of course, possible to render certain payments which would otherwise be unlawful financial assistance lawful by means of the procedures set out in section 155 of the Companies Act 1985. However, such a route is most unlikely to assist the taxation planning since it carries with it an effective admission that the purpose of the payment is to assist with the sale of the shares and not for some other business or larger purpose of the target company. The suggestion that the procedure was adopted as a matter of caution because of the potentially serious consequences of a breach of section 151 of the Companies Act 1985 is likely to be greeted by the Inland Revenue with scepticism and in most situations may not be regarded as carrying a great deal of persuasive weight.

Other company law issues

The mechanics of company law have to be carefully observed such as where, as indicated above, a company is unable to pay a divided but wishes to create some form of distribution or return of capital by acquiring its own shares from the members. The company law limits of this power to return capital to the members need to be carefully observed.[56] It is a fundamental rule of company law, based upon decisions of long-standing such as *Trevor v Whitworth*,[57] that a company cannot acquire its own shares, and this has been restated in section 143 of the Companies Act 1985. To this there are certain specific exemptions. They can apply where the company's share capital is reduced or cancelled by means of a resolution brought into effect by the sanction of the Court pursuant to section 135 of the Companies Act 1985 and it would appear from decisions such as *Re David Bell*[58] and *ex parte Westbury Sugar Refineries*[59] that the mere fact that the company's application for the reduction of capital to be approved is motivated by desire to obtain a particular taxation structure for the return of capital that is beneficial to the members is not an objection to obtaining Court sanction.[60]

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56 There may also be issues with the Inland Revenue as to whether transfers of assets within a group of companies "realises" the capital profits in that asset for the purposes of creating distributable reserves - see Reginald S Nock and Simon Nock `Illegal Dividends` *The Receivers, Administrators and Liquidators Quarterly*, Volume 3, 1997, Issue 2 at page 75.

57 (1887) 12 App Cas 496.

58 35 ATC 94.

59 [1951] 1 All ER 881.

60 But note the unreported decision in *Re Ryelands White cross* that the Court should not sanction a scheme of arrangement put forward solely for the purpose of mitigating stamp duty, but in that case the parties could have performed their bargain without the assistance of the Court, whereas in the company law cases cited in the main text the Court was merely asked to sanction a step that

In relation to a company's purchase of own shares it is frequently suggested that the redemption of redeemable preference shares would not attract the charge to stamp duty which would otherwise arise,[61] and that the tax can be saved by converting the shares or an appropriate part thereof into redeemable shares. However, in addition to the problem that it is not always possible to redeem preference shares out of capital,[62] whilst it appears to be possible for a company to convert existing share capital into redeemable share capital as part of some form of reduction or scheme of arrangement with the sanction of the Court,[63] it seems clear that a company cannot simply by resolution change the nature of its share capital. The provisions in the Companies Act relating to the redemption of preference shares are quite clear that the shares must be "issued" as redeemable shares and not converted, since the redemption might in certain circumstances constitute a return of capital of the members without the sanction of the Court.[64] Moreover, the Companies Act 1985 itself provides that where there is a purchase by a company of its own shares not in accordance with the provisions of the Companies Act this is a criminal offence punishable by a fine or imprisonment or both for the company and any relevant officer.[65]

Obviously, the variations upon the theme as to when a tax planning transaction infringes company law are many,[66] but recent decisions indicate that the increasing use of criminal sanctions in order to secure observance of the requirements of company law means that the interaction of these two areas of law is becoming even more important.

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was not the actual completion of the transaction but was merely one stage in the process of enabling the parties to carry out the final transaction in a tax efficient manner.

61 Finance Act 1986 section 66.

62 See Companies Act 1985 section 160 and section 171.

63 *Re Forth Wines Ltd* [1991] BCC 638.

64 *Re St James Court* [1944] Ch 6.

65 Companies Act 1985 section 143(2).

66 See discussions such as *Ridge Securities Ltd v I.C.* [1964] 3 All ER 1109; and *Petrolia Securities Ltd v Acres* [1964] 1 All ER 269 on whether overvalue or undervalue transactions are *ultra vires*.