

JUDICIAL ANTI-AVOIDANCE DOCTRINES AFTER *COUNTESS FITZWILLIAM*

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Introduction

Much has been written, and no doubt much more will be written, about the judicial anti-avoidance decisions introduced into English law by the House of Lords in *Ramsay* and *Furniss v Dawson*. In this article, I consider their subtle but fundamental undermining in *Countess Fitzwilliam*. *Fitzwilliam* has received less attention than it should, perhaps because the two artificial schemes in that case were complex and take some time to understand. Once understood, however, the basic point on the judicial doctrine is a very short and simple one. In my view *Fitzwilliam* comes perilously close to overruling *Furniss v Dawson*. The House of Lords has given itself freedom to depart from the judicial doctrines whenever it wishes to do so on the grounds that, notwithstanding that arrangements were all predestined, it is not intellectually possible realistically to treat the steps involved as constituting a single and indivisible whole in which one or more of them was simply an element without independent effect.

1 The Judicial Nature of the Doctrines

The rules in *Ramsay* and *Furniss v Dawson* were invented by the courts. They changed the law retrospectively so as to impose charges to tax where none had existed before. Their introduction offended some basic principles of our unwritten constitution and some written rules too. A whole wealth of learning, of precedent and of authority was by-passed. The Appellate Committee of the House of Lords was imposing taxation on the subject without the warrant of parliamentary

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authority. It was disregarding its own precedents, which had held that a charge to tax could be imposed only by the clear words of a statute.

It is not my purpose in this paper to point out the disadvantages of judge-made law in general: they are too well known. Nor is it my purpose to complain about the impropriety of what was done. The House of Lords did what they did and they got away with it, as they knew full well they would. It is as pointless for a subject caught by the new rules to complain of unfair treatment as it would have been for a Jew in Nazi Germany to complain about the German courts construing constitutional guarantees as being impliedly available only to Aryans.

Their Lordships, and other judges since, obviously felt some qualms about this "naked usurpation of the legislative function" and were to some extent shamed, if not into curtailing the usurpation, at least into covering its nakedness. This led to a divergence between what they were saying and what they were doing. Provided everyone understands the coded language in which they speak, there is no problem. We are simply within the realm of legal fiction. When such fictions first develop, their nature may not be immediately clear. Once they are firmly established, they can be freely described as what they are.

Take the example of the fiction of the modern lost grant, which was invented to make good the shortcomings of the law of prescription. Judges at first tentatively advised juries that from twenty years user *nec vi nec clam nec precario* they could infer that a grant of the easement in question had been made but the deed had been lost. As time passed, judges began instructing juries that from twenty years such user they must infer a grant. Finally, once the practice was well established, the stage was reached when the doctrine was seen to be a legal fiction and freely acknowledged as a judge-made amendment of the substantive law of prescription.

In the cases of *Ramsay* and *Furniss v Dawson* it would, in my respectful view, have been preferable for the judges plainly to admit that they were making new law and to lay down unequivocally the scope of the new rules. Normally, the longer a judicial doctrine has been established, the more openly is it treated as such. In this case, the tide has turned against the judicial doctrines and later judges have been anxious to keep them within metes and bounds and even to "repeal" them in part. Later judges have ironically been able to seize on the obfuscatory language of the earlier decisions to justify departing from them in the guise of following them. Needless to say, unless the reader keeps a very firm eye on what is being done, and is not distracted by what is being said, he is liable to be misled.

In this section of the paper, I shall first examine *Ramsay* from this viewpoint. I shall then include a perfunctory and uncritical account of *Furniss v Dawson* and *Craven v White*. Finally, I shall show that in *Countess Fitzwilliam* the House of Lords has all but emasculated the doctrine, at least where the tax planning is of the sort of which, and/or is undertaken by a category of person of whom, they approve.

2 *W.T. Ramsay Ltd v IRC*²

Ramsay was the first decision which really introduced the new doctrine. Of course, with hindsight one can point back to its harbingers. For example, *Chinn v Collins*³ had been decided by the House of Lords a few months earlier in favour of the Revenue only by distorting trust law. It came as a considerable relief to trust lawyers that it could retrospectively be characterised simply as an (unconscious) application of the *Ramsay* principle and left the integrity of trust law undiminished.

Now what *Ramsay* really decided was that where a taxpayer enters into a series of transactions the only purpose of which is to secure that he realise a loss which is allowable for tax purposes and where, apart from the costs of the exercise, the taxpayer at the end of the series of transactions is in exactly the same financial position as before, then the loss is to be disregarded for tax purposes. That is a perfectly intelligible and workable rule which the courts could have later chosen to extend as far as they thought fit.

The reasoning of the judges is rather different. Lord Wilberforce, with whose speech Lords Russell, Roskill and Bridge agreed, said:

“In these circumstances, your Lordships are invited to take, with regard to schemes of the character I have described, what may appear to be a new approach. We are asked, in fact, to treat them as fiscally a nullity, not producing either a gain or a loss. Counsel for *Ramsay* described this as revolutionary, so I think it opportune to restate some familiar principles and some of the leading decisions so as to show the position we are now in.

1. A subject is only to be taxed on clear words, not on ‘intendment’ or on the ‘equity’ of an Act. Any taxing Act of Parliament is to be construed

² [1981] STC 474.

³ [1981] STC 1.

in accordance with this principle. What are 'clear words' is to be ascertained on normal principles; these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded: see *Inland Revenue Comrs v Wesleyan and General Assurance Society* [1946] 2 All ER 749 at 751, 30 Tax Cas 11 at 16 per Lord Greene MR and: *Mangin v Inland Revenue Comrs* [1971] 1 All ER 179 at 182, [1971] AC 739 at 746 per Lord Donovan. The relevant Act in these cases is the Finance Act 1965, the purpose of which is to impose a tax on gains, less allowable losses, arising from disposals.

2. A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides. It must be considered according to its legal effect.

3. It is for the fact-finding commissioners to find whether a document, or a transaction is genuine or a sham. In this context to say that a document or transaction is a 'sham' means that while professing to be one thing, it is in fact something different. To say that a document or transaction is genuine, means that, in law, it is what it professes to be, and it does not mean anything more than that. I shall return to this point.

Each of these three principles would be fully respected by the decision we are invited to make. Something more must be said as to the next principle.

4. Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance. This is the well-known principle of *Inland Revenue Comrs v Duke of Westminster* [1936] AC 1, 19 Tax Cas 490. This is a cardinal principle but it must not be overstated or over-extended. While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded; to do so is not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded. For this there is

authority in the law relating to income tax and capital gains tax: see *Chinn v Collins (Inspector of Taxes)* and *Inland Revenue Comrs v Plummer*.

For the commissioners considering a particular case it is wrong, and an unnecessary self-limitation, to regard themselves as precluded by their own finding that documents or transactions are not 'shams' from considering what, as evidenced by the documents themselves or by the manifested intentions of the parties, the relevant transaction is.

They are not, under the *Duke of Westminster* doctrine or any other authority, bound to consider individually each separate step in a composite transaction intended to be carried through as a whole. This is particularly the case where (as in *Rawling*) it is proved that there was an accepted obligation once a scheme is set in motion, to carry it through its successive steps. It may be so where (as in *Ramsay* or in *Black Nominees Ltd v Nicol (Inspector of Taxes)* [1975] STC 372, 50 Tax Cas 229) there is an expectation that it will be so carried through, and no likelihood in practice that it will not. In such cases (which may vary in emphasis) the commissioners should find the facts and then decide as a matter (reviewable) of law whether what is in issue is a composite transaction or a number of independent transactions."

Now despite Lord Wilberforce's words, the first and second principles are not at all "respected" by the decision in the case, as the decision establishes a new rule which is a derogation from those principles. Likewise, the decision introduced a qualification to the rule in *Duke of Westminster*.

When he makes the statements quoted, he is camouflaging what he is really doing. The rule in *Ramsay* is not a rule of construction at all, in any normal sense of the word. Even if one construed all the documents in *Ramsay* in their context and viewed them as part of an overall scheme, what they did was to produce an allowable loss and an equal and opposite non-chargeable gain. The two cancelled each other out in the real world but not in the world of the capital gains tax legislation. It is only by applying the new rule of law that one can disregard the allowable loss.

Lord Wilberforce's motive for the camouflage is plainly revealed at page 162 of his speech:

"Before I come to examination of the particular schemes in these cases, there is one argument of a general character which needs serious consideration. For the appellants it was said that to accept the Crown's wide contention involved a rejection of accepted and established canons,

and that, if so general an attack on schemes for tax avoidance as the Crown suggest is to be validated, that is a matter for Parliament. The function of the courts is to apply strictly and correctly the legislation which Parliament has enacted: if the taxpayer escapes the charge, it is for Parliament, if it disapproves of the result, to close the gap. General principles against tax avoidance are, it was claimed, for Parliament to lay down."

His Lordship's answer was, at page 162:

"I have a full respect for the principles which have been stated but I do not consider that they should exclude the approach for which the Crown contends. That does not introduce a new principle: it would be to apply to new and sophisticated legal devices the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation. While the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still. Such immobility must result either in loss of tax, to the prejudice of other taxpayers, or to Parliamentary congestion or (most likely) to both. To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated, would be a denial rather than an affirmation of the true judicial process. In each case the facts must be established, and a legal analysis made: legislation cannot be required or even be desirable to enable the court to arrive at a conclusion which corresponds with the parties' own intentions.

The capital gains tax was created to operate in the real world, not that of make-belief. As I said in *Aberdeen Construction Group Ltd v Inland Revenue Comrs* [1978] 1 All ER 962, [1978] AC 885, [1978] STC 127, it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, is not such a loss (or gain) as the legislation is dealing with, is in my opinion well, and indeed essentially, within the judicial function."

Again, this is totally unconvincing. If he had plainly stated that he was proposing to introduce a judge-made rule, one would have had more respect for him. As it is, he pretends that the solution is to be found in "legal analysis" of the facts. And if one is speaking of the parties' intentions, what can be more certain that they

intended to realise an allowable loss and a non-chargeable gain, not to realise neither?

The dictum in *Aberdeen Construction Group Ltd* is the first refuge of a desperate taxpayer, and the last refuge of some not so desperate ones. It has minimal importance. If, for example, I sell an asset for a series of payments in dollars, I must quantify the total price in sterling at the date of the sale. If, because the dollar drops against the pound before later payments are made, my real gain is less, I am taxable on the arithmetical difference prescribed by the Taxation of Chargeable Gains Tax Act 1992 and not on my real gain. See the decision of Lloyd J in *Loffland Bros North Sea Inc v Goodbrand* [1997] STI 30.

3 *Furniss v Dawson*⁴

The following account is taken from the speech of Lord Keith in *Fitzwilliam* [1993] STC 502:

“The taxpayers (the Dawsons) owned all the shares in two family companies. They reached an informal agreement to sell the shares at an agreed price to a purchaser (Wood Bastow). On 16 December 1971 the Dawsons incorporated a company (Greenjacket) in the Isle of Man, and draft agreements were made for the purchase by Greenjacket of the shares in the family companies in exchange for the issue to the Dawsons of 151,500 shares of 1p each in Greenjacket at a premium of 99p and for the sale of the family company shares by Greenjacket to Wood Bastow at the price of £151,500. On 20 December 1971 the share transfer and the sale to Wood Bastow took place. The object of the exercise was to postpone any charge to capital gains tax until such time as the Dawsons disposed of their shares in Greenjacket. This would be achieved if Greenjacket, in exchange for the issue of its shares to the Dawsons, obtained control of the family companies, that being the effect of paragraphs 4(2) and 6(1) of Schedule 7 to the Finance Act 1965. It was held by the House of Lords that the Dawsons were liable to capital gains tax as if they had sold the shares in the family companies to Wood Bastow directly in consideration of the price of £151,500 paid to Greenjacket. The intermediate transfer of the shares to Greenjacket, since it had no business purpose apart from the deferment of capital gains tax, fell to be disregarded for fiscal purposes, so that Greenjacket never acquired control of the family companies. Lord Brightman, who delivered the leading speech, said ([1984] STC 153 at 166, [1984] AC 474 at 526-527):

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[1984] STC 153, [1984] AC 474.

'My Lords, in my opinion the rationale of the new approach is this. In a preplanned 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. In a contractual case the fiscal consequences will naturally fall to be assessed in the light of the contractually agreed results. For example, equitable interests may pass when the contract for sale is signed. In many cases equity will regard that as done which is contracted to be done. *Ramsay* says that the fiscal result is to be no different if the several steps are preordained rather than precontracted. For example, in the instant case tax will, on the *Ramsay* principle, fall to be assessed on the basis that there was a tripartite contract between the taxpayers, Greenjacket and Wood Bastow under which the taxpayers contracted to transfer their shares in the operating companies to Greenjacket in return for an allotment of shares in Greenjacket, and under which Greenjacket simultaneously contracted to transfer the same shares to Wood Bastow for a sum in cash. Under such a tripartite contract the taxpayers would clearly have disposed of the shares in the operating companies in favour of Wood Bastow in consideration of a sum of money paid by Wood Bastow with the concurrence of the taxpayers to Greenjacket. Tax would be assessed, and the base value of the Greenjacket shares calculated, accordingly. *Ramsay* says that this fiscal result cannot be avoided because the preordained series of steps are to be found in an informal arrangement instead of in a binding contract. The day is not saved for the taxpayer because the arrangement is unsigned or contains the magic words this is "not a binding contract".'

"The significance of this passage, which contains the essential ratio decidendi of the case, is that it demonstrates the intellectual basis on which the House was able to reach the conclusion that the fiscal consequences which would ordinarily have resulted from a transfer to Greenjacket in exchange for shares in the latter followed by a sale by Greenjacket to Wood Bastow for cash were not attracted. All the parties involved had informally agreed on what was to happen but were not formally bound to bring that about. The *Ramsay* principle made it possible to hold that the final result for fiscal purposes was the same as it would have been if the parties had been so formally bound."

4 *Craven v White*⁵

In *Craven v White*, the House of Lords decisively rejected any extension of the principles to an all embracing generalised rule that any transaction entered into for the purpose of avoiding tax on some later transaction is on that ground alone to be disregarded for fiscal purposes. They went much further in severely limiting the degree of predestination required to bring the doctrines into operation. As Lord Keith said in *Countess Fitzwilliam* [1993] STC 502:

“In *Craven (Inspector of Taxes) v White* ... this House decisively rejected the argument for the Crown that any transaction entered into for the purpose of avoiding tax on some later transaction was on that ground alone to be disregarded for fiscal purposes. There were three cases involved, of which *Craven v White* itself bore a close resemblance on the facts to *Furniss v Dawson*. The difference was that at the time when the shares which the taxpayers proposed to sell were transferred to the intermediate company no agreement, however informal, had yet been reached with the ultimate purchaser. Negotiations were in progress, but it was uncertain whether agreement would be reached or what the terms of any agreement would be. Agreement was reached some 21 days after the intermediate transfer. It was held by a majority that the intermediate transfer could not be disregarded for fiscal purposes, so that the relevant provisions of Schedule 7 to the Finance Act 1965 applied to the effect of deferring any charge to capital gains tax.

Lord Oliver, in the course of a closely reasoned speech agreed with by myself and Lord Jauncey, said ([1988] STC 476 at 494-495, [1989] AC 398 at 498), after referring to the passage from Lord Brightman’s speech in *Furniss v Dawson* quoted above:

‘The transactions which are before your Lordships in these three appeals all display the same basic pattern as the *Dawson* transactions in the sense that there has been an ultimate purchase of property originally in the beneficial ownership of the taxpayer which, before the completion of the purchase, has been vested in an intermediate company or companies controlled by the taxpayer or, in the case of the *IRC v Bowater Developments Ltd* appeal, by the parent company of the taxpayer. In each case, however, one or more of the salient features present in the *Furniss v Dawson* transactions is missing. In particular the transactions which, in each appeal, the Crown seeks now to reconstruct into a single

⁵ [1988] STC 476.

direct disposal from the taxpayer to an ultimate purchaser were not contemporaneous. Nor were they preordained or composite in the sense that it could be predicated with any certainty at the date of the intermediate transfer what the ultimate destination of the property would be, what would be the terms of any ultimate transfer or even whether an ultimate transfer would take place at all. In none of the three appeals therefore do the facts match with the criteria set out in Lord Brightman's speech.'

"Later Lord Oliver said ([1988] STC 476 at 503, [1989] AC 398 at 509):

'My Lords, for my part I find myself unable to accept that *Dawson* either established or can properly be used to support a general proposition that any transaction which is effected for the purpose of avoiding tax on a contemplated subsequent transaction and is therefore "planned" is, for that reason, necessarily to be treated as one with that subsequent transaction and as having no independent effect even where that is realistically and logically impossible. The particular question which fell to be determined in *Dawson* was, as it is in the present appeals, whether an intermediate transfer was, at the time when it was effected, so closely interconnected with the ultimate disposition that it was properly to be described as not, in itself, a real transaction at all but merely an element in some different and larger whole without independent effect. That is, I think, necessarily a question of fact but it has to be approached within the bounds of what is logically defensible.'

5 *Countess Fitzwilliam v Commissioners of Inland Revenue*⁶

5.1 Overview

The *Fitzwilliam* case concerned two highly complex and completely artificial tax avoidance strategies which Lord Templeman, in his dissenting speech, described as "trembling on the brink of a sham".⁷ The purpose of the schemes was to transfer wealth from the estate of Lady Fitzwilliam to that of her daughter, Lady Hastings, avoiding the charge to inheritance tax which would otherwise have been occasioned. The schemes, which have long since been closed by legislation, took

⁶ [1993] STC 502.

⁷ See footnote 10.

advantage of the mutual transfer relief and the reverter to settlor relief respectively.

The House of Lords held that notwithstanding that the arrangements were all predestined, the doctrines did not apply so as to allow the transactions to be re-characterised, because it was not intellectually possible realistically to treat them as constituting a single and indivisible whole in which one or more of them was simply an element without independent effect.

5.2 The Facts

The Tenth Earl Fitzwilliam died unexpectedly on 21st September 1979 at the age of 75, leaving his net residuary estate on discretionary trusts during a period which could not exceed 23 months from the date of his death with power to appoint capital or income in favour of a class of beneficiaries which included Lady Fitzwilliam, Lady Hastings and Mr Philip Naylor-Leyland, Lady Hastings' son. The following steps were taken:

Step 1

By a deed of appointment dated 20th December 1979 the trustees appointed that a part of the residuary estate to the amount or value of £4m should thenceforth be held in trust as to both capital and income for Lady Fitzwilliam absolutely. The Revenue accepted in the House of Lords that step 1 did not form part of any preordained single composite transaction, merely that steps 2, 3, 4 and 5 constituted a preordained single composite transaction.

Step 2

On 7th January 1980 Lady Fitzwilliam drew a cheque for £2m, post-dated to 9th January, in favour of Lady Hastings. The £2m was raised by the trustees on loan from Hambros Bank and appropriated towards Lady Fitzwilliam's £4m appointment. On the same day Lady Fitzwilliam signed a letter addressed to Lady Hastings, also post-dated to 9th January, in which she stated that the £2m was an outright gift and that she intended it to be net of capital transfer tax, which would be paid by her. The cheque and the letter were handed to Lady Hastings by Currey & Co on 9th January, the cheque being subsequently cleared and its proceeds credited to a deposit account of hers.

Step 3

By a deed of appointment (the £3.8m appointment) dated 14th January 1980 the trustees appointed that a part of the balance of the residuary estate to the amount or value of £3.8m should be held on trust to pay the income to Lady Fitzwilliam until whichever was the earlier of 15th February 1980 and the date of her death; subject thereto as to one moiety (the vested moiety) in trust for Lady Hastings absolutely and as to the other moiety (the contingent moiety) in trust for Lady Hastings contingently on her being alive at the date of the determination of Lady Fitzwilliam's income interest; and subject thereto in trust for Mr Philip Naylor-Leyland absolutely.

Step 4

By a deed of assignment (the first assignment) dated 31st January 1980 and made between Lady Fitzwilliam of the one part and Lady Hastings of the other part Lady Fitzwilliam, by her attorney and in consideration of the sum of £2m then paid by Lady Hastings to Lady Fitzwilliam, assigned to Lady Hastings for her own use and benefit absolutely her interest in the income of the contingent moiety.

Step 5

By a settlement (Lady Hastings' settlement) dated 5th February 1980 and made between Lady Hastings of the one part and two trustees of the other part Lady Hastings settled a sum of £1,000 on trust to pay the income thereof to Lady Fitzwilliam until her death or until 15th March 1980 (whichever should first occur) and subject thereto on trust as to both capital and income for Lady Hastings absolutely. By a deed of assignment (the second assignment) dated 7th February 1980 and made between Lady Hastings of the one part and the trustees of Lady Hastings' settlement of the other part Lady Hastings assigned to those trustees her absolute reversionary interest in the vested moiety to be held by them as an addition to the funds of Lady Hastings' settlement.

The contingent moiety passed out of Countess Fitzwilliam's deemed ownership into Lady Hastings' deemed ownership, and subsequent actual ownership, without any charge to tax on the settled property, as the consideration Lady Hastings gave was equal to the value of the entire moiety, and not just Countess Fitzwilliam's interest in that moiety.⁸ Lady Hastings made a substantial chargeable transfer of value

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See now Inheritance Tax Act 1984 section 54(2).

equal to the difference between the value of the contingent moiety and of the short interest in possession in it which she had acquired. That transfer of value and the earlier gift of cash by her mother more or less cancelled each other out under the mutual transfer provisions.

As regards the vested moiety, Lady Hastings sought to avoid the charge on the termination of her mother's interest in possession by relying on the reverter to settlor exemption.⁹

5.3 The Revenue's Contentions

The case for the Crown was that, on the *Ramsay* principle, the contingent moiety became liable to capital transfer tax when Lady Fitzwilliam's income interest in it terminated; and that the vested moiety became similarly liable when her income interest in it terminated. Thus, the Crown accepted that step 3 was wholly effective in giving Lady Fitzwilliam an income interest in the whole £3.8m until 15th February 1980 and in giving Lady Hastings a vested and a contingent interest respectively in the capital of each of the two moieties. It also involved an acceptance that by step 4 Lady Fitzwilliam effectively assigned to Lady Hastings her limited income interest in the contingent moiety, and that by step 5 Lady Hastings effectively conferred on Lady Fitzwilliam an income interest in the vested moiety until 15th March 1980. The Crown then sought to assimilate the situation to that which would have existed had there been a contract between Earl Fitzwilliam's trustees, Lady Fitzwilliam and Lady Hastings under the terms of which Lady Hastings agreed to accept the £2m from Lady Fitzwilliam on condition that she would return it after the appointment by the trustees under step 3 which the trustees under the contract agreed to make, so that in effect Lady Hastings gave no consideration for Lady Fitzwilliam's assignment to her of the latter's limited income interest in the contingent moiety and thus could not take advantage of the exemption for purchased interests. As regards the vested moiety the postulated contractual terms were that on condition of the trustees creating the reversionary interest in her favour under step 3 Lady Hastings agreed to settle that interest on the trusts of step 5. Thus Lady Hastings did no more than comply with the condition on which the reversionary interest was conferred on her.

⁹ The exemption is now contained in Inheritance Tax Act 1984 section 53(3). The exemption does not apply if its application would depend on a reversionary interest having been transferred into a settlement on or after 10th March 1981. See section 53(5)(b).

5.4 The Reasoning

Lord Keith said:

“In the present case, therefore, the correct approach to a consideration of the four steps in the tax-saving plan which the Crown says were ineffective for the purpose is to ask whether realistically they constituted a single and indivisible whole in which one or more of them was simply an element without independent effect and whether it is intellectually possible so to treat them.”

After discussing the Revenue's contentions in the light of the facts, he continued:

“In my opinion this cannot be regarded as a realistic or intellectually possible view of the matter. It does not depend on disregarding for fiscal purposes any one or more of the transactions involved in steps 2 to 5, as having been introduced for fiscal purposes only and as having no independent effect for those purposes, nor on treating the whole series of steps as having no such effect. Each of the steps 2, 3, 4 and 5 had the fiscal effect of giving rise to a charge to income tax on Lady Hastings or on Lady Fitzwilliam for a period of time, and there was a potential charge to capital transfer tax if either had died while in enjoyment of the income. Although the commissioners found as a fact that Lady Hastings accepted the £2m as a genuine unconditional gift from her mother, the Crown's case seeks to make it a conditional gift. Further, although all the transactions were accepted by the commissioners as genuine, the Crown's case seeks to make out that step 4 was not an assignment for a consideration but a gratuitous assignment. No case applying the *Ramsay* principle has yet held it to be legitimate to alter the character of a particular transaction in a series or to pick bits out of it and reject other bits. In *Furniss v Dawson* the transfer to the intermediary company Greenjacket was disregarded for fiscal purposes because of the pre-existing informal agreement and of the manner in which the two transactions were carried out, which made it intellectually possible to hold that Greenjacket never had control of the operating companies within the meaning of the statute. No comparable exercise is possible here.”

He then made clear that predestination is not enough to bring the doctrine into play:

“In the present case I would accept that steps 2, 3, 4 and 5 were preordained in the sense that they all formed part of a preplanned tax avoidance scheme and that there was no reasonable possibility that they

would not all be carried out, notwithstanding the pause while Lady Hastings as an individual took independent legal advice. But the fact of preordainment in this sense is not sufficient in itself, in my opinion, to negative the application of an exemption from liability to tax which the series of transactions is intended to create, unless the series is capable of being construed in a manner inconsistent with the application of the exemption. The series in *Furniss v Dawson* was capable of being so construed, for the reasons explained by Lord Brightman. In my opinion the series in the present case cannot be. The problem for the Crown is that as regards the contingent moiety it has to rely on step 3 as creating an income interest in Lady Fitzwilliam until 15th February 1980 and on step 4 as terminating that interest. As regards the vested moiety it relies on step 3 as creating an income interest in Lady Fitzwilliam until 15th February 1980 and on step 5 as prolonging that interest to 15th March 1980 and then terminating it. There is no question of running any two or more transactions together, as in *Furniss v Dawson*, or of disregarding any one or more of them. I am unable to perceive any rational basis on which steps 2, 3 and 4 can be treated as effective for the purpose of creating a charge to tax under para 4(2) of Schedule 5 to the 1975 Act but ineffective for the purpose of attracting the exemption in para 4(4) and that in para 4(5)."

He therefore concluded that the case did not fall within the *Ramsay* principle as extended by *Furniss v Dawson*.

5.5 Critique

5.5.1 What did *Fitzwilliam* decide?

Fitzwilliam clearly represents an important check on the operation of the judicial doctrine. Not even a wholly artificial series of predestined transactions entered into for a tax avoidance purpose will necessarily suffice. Yet what is the limiting factor? When is it not "intellectually possible" to hold that "realistically" steps constitute a single and indivisible whole in which one or more of them is simply an element without independent effect?

The meaning of this phrase is obscure, yet it was used to justify refusing to apply *Furniss v Dawson* in a situation where it clearly four-square applied. Indeed, a court which was prepared to find in favour of the taxpayer in *Fitzwilliam* could as easily do so if the identical facts of *Furniss v Dawson* were to re-occur.¹⁰ It

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I ignore the fact that the precise scheme would now be scuppered by anti-avoidance legislation.

would have difficulty in not doing so if the taxpayer ensured that a dividend was paid to Greenjacket by the target companies before it sold their shares!

I cannot see the slightest intellectual difficulty in the way of their Lordships reaching the conclusion that the contingent moiety became liable to inheritance tax on the assignment by Lady Fitzwilliam to Lady Hastings. Stripping the case to its bare essentials, mother gave daughter £2,000,000 on terms that daughter would return it to mother as the purchase price of an asset worth only a tiny fraction of that amount. The only reason that the money went round in a circle was to obtain a tax advantage. Why cannot one disregard this circular element and simply treat the money as having stayed with the mother all along? The analysis would be that the substance of the transaction for tax purposes was a gift of the interest in possession. This analysis would scarcely have involved any extension of the established doctrine.

Let us suppose that for some reason such a simple solution is not possible. The same, or virtually the same, result can be reached by the route that that which is preordained is equivalent to that which is precontracted. In a passage in *Furniss v Dawson* which Lord Keith in *Fitzwilliam* treated as containing the essential ratio decidendi of the case,¹¹ Lord Brightman said:

“My Lords, in my opinion the rationale of the new approach is this. In a preplanned 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. In a contractual case the fiscal consequences will naturally fall to be assessed in the light of the contractually agreed results. For example, equitable interests may pass when the contract for sale is signed. In many cases equity will regard that as done which is contracted to be done. *Ramsay* says that the fiscal result is to be no different if the several steps are preordained rather than precontracted.”

Apply that test to the scheme concerning the contingent moiety. Lady Hastings should be treated as having entered into a legally binding agreement that she would return the gifted £2,000,000 to Lady Fitzwilliam in return for the assignment of her interest in possession in the contingent moiety. If one analyses what happened in terms of contract, Lady Hastings would have provided the £2,000,000 to a very small extent only in consideration of the life interest of very little value but principally in consideration of the initial payment of £2,000,000 to her. The

¹¹ The passage is cited more fully at 3.

settled property would thus have been liable to capital transfer tax on the assignment, with only a tiny abatement of the value transferred corresponding to the consideration given for the interest. Alternatively, if one looks at the matter in terms of equitable interests, the analysis is that the £2,000,000 never belonged beneficially to Lady Hastings but that Lady Fitzwilliam held her interest in possession upon trust for herself until the date of the projected assignment and thereafter on trust for Lady Hastings. Again, the assignment would have given rise to a charge to capital transfer tax.

As regards the vested moiety, if there was an agreement between the trustees, mother and daughter, that a vested remainder would be appointed to the daughter on terms that she re-settled it on trust for her mother for a period with remainder to herself, the daughter would have held the remainder so appointed upon such trusts even before she re-settled it. The trust would have been a constructive one. She would never in equity have been the owner of the interest she was bound to transfer to her mother. All she would have owned would have been the ultimate remainder under the compound settlement. Thus she could not have been a settlor in relation to that compound settlement, with the result that when she became absolutely entitled to the settled property there would have been no reverter to settlor exemption from the charge on the termination of her mother's interest in possession.

What of the argument that because Lady Fitzwilliam was entitled to income of the settled property for a brief period and was actual taxable on it (or would, in the case of the vested moiety, have been so taxable but for the income tax settlement provisions)? In the first place, it was not obvious why one should have to restructure a transaction the same way for all taxes. Their Lordships appear to have introduced an important qualification to the operation of the doctrine. Whether their views on the income tax position could be held to be *obiter dicta* is an interesting question. In any event, I do not see how the suggested re-characterisation is in any way inconsistent with the income tax position. One accepts that the respective interests of mother and daughter in the settled property and their entitlements to income were for tax purposes those to which they were entitled in reality. In the case of the contingent moiety, one simply does not accept that the daughter purchased her mother's interest; the income tax charges are completely unaffected by the operation of the doctrine. In the case of the vested moiety, one does not accept that she was a settlor. If this analysis has to be followed through for income tax purposes, there is no problem in so doing. The only difference is that Lady Fitzwilliam would have been taxable on the income arising between 15th February and 15th March, instead of Lady Hastings being taxable as settlor under the income tax settlement provisions.

5.5.2 Who can Rely on *Fitzwilliam*?

The major problem with *Fitzwilliam* is that, from the taxpayers' point of view, it is too good to be true. Their Lordships clearly had enormous sympathy with a landed aristocratic family seeking to preserve its estates. As Lord Keith said:

"... it was natural for the trustees to consider whether any steps might usefully be taken without delay such as could reduce the incidence of tax on her death by way of what might not improperly be described as strategic tax planning. Steps of that character had been undertaken, in a vast number of cases, under the estate duty regime which came to an end with the introduction of capital transfer tax in 1975, by way of arrangements approved by the court, under the Variation of Trusts Act 1958, on behalf of minor and unascertained beneficiaries of a settlement."

It is an open question whether their Lordships would have dealt so tenderly with, say, a scheme to avoid capital gains tax on the sale of a successful trading company by the son of one of the workers on the *Fitzwilliam* estate.

5.5.3 A Comparison with the Facts of *Furniss v Dawson*

Let us apply the reasoning in *Fitzwilliam* to the facts of *Furniss v Dawson*. Lord Brightman explained, in the continuation of the passage last cited, how the transactions in that case were to be re-analysed:

"For example, in the instant case tax will, on the *Ramsay* principle, fall to be assessed on the basis that there was a tripartite contract between the taxpayers, Greenjacket and Wood Bastow under which the taxpayers contracted to transfer their shares in the operating companies to Greenjacket in return for an allotment of shares in Greenjacket, and under which Greenjacket simultaneously contracted to transfer the same shares to Wood Bastow for a sum in cash. Under such a tripartite contract the taxpayers would clearly have disposed of the shares in the operating companies in favour of Wood Bastow in consideration of a sum of money paid by Wood Bastow with the concurrence of the taxpayers to Greenjacket. Tax would be assessed, and the base value of the Greenjacket shares calculated, accordingly."

So the House of Lords re-characterised an exchange by the taxpayers of shares in the target companies for shares in Greenjacket followed by an onward sale of the shares in the target companies to Wood Bastow as a sale by the taxpayers of the shares in the target company to Wood Bastow followed by a subscription of the sale proceeds for shares in Greenjacket. The interposition of Greenjacket had far

more enduring consequences than the transfer of £2,000,000 from Lady Fitzwilliam to Lady Hastings and back again. It did not involve inserted steps which could be simply ignored on the basis that they were self-cancelling, as the proceeds of the target company shares finished up being owned by Greenjacket rather than by the taxpayers. Hence, Lord Brightman had to go further and re-characterise what had actually happened as something rather different, albeit ending in the same result, except for the tax consequences. If their Lordships in *Fitzwilliam* found difficulty in ignoring the mere passing of money in a circle, it is difficult to see how with any measure of intellectual honesty or consistency they could have embarked on such a more extensive re-characterisation as was undertaken by their predecessors in *Furniss v Dawson*. When the ratio of a decision is so qualified by a later case that the result of the earlier decision would have been different, one is coming perilously close to overruling that decision.

Now, realistically, it would be difficult as at present to convince any court, including their Lordships' House, that a case with identical facts to *Furniss v Dawson* should now be decided differently, even if it could arise. But suppose that the facts of a new case were the same except that during the period that Greenjacket II owned the target company shares a small dividend were declared on those shares so that an income tax liability arose.¹² It would appear from *Fitzwilliam* that Lord Brightman's re-characterisation would no longer be possible.

5.5.4 Some Predictions

Certain cases will be very difficult to distinguish from *Fitzwilliam*. Broadly speaking, I would expect *Fitzwilliam* to be followed more closely where inheritance tax or trusts are concerned and would be very surprised if it were not followed where both were involved.

A non-UK domiciliary has a life interest in a settlement created by a United Kingdom domiciled settlor. If she were simply to make a gift of it to the remainderman, she would make a transfer of value. Instead, she gives the remainderman cash situate outside of the United Kingdom (and thus constituting excluded property) equal in value to the settled property on the understanding, not legally enforceable, that he will use the money to purchase her life interest. He does so. She makes no transfer of value at either stage.

A wishes to make a gift of cash to a discretionary trust. He gifts to the trustees of the settlement property qualifying for 100% agricultural relief equal in value to the intended cash gift on the understanding, not legally enforceable, that the

¹² The liability would arise under Taxes Act 1988 section 739 and would prima facie be on the shareholders of the target company who had procured the transfer.

trustees will sell the property back to him. They do so. A's chargeable transfer qualifies for 100% relief.¹³

The result even in these cases is not beyond argument. While *Fitzwilliam* on any view represents a considerable back-tracking on *Furniss v Dawson*, taxpayers and their advisers need to ask themselves in which cases the courts will in future refuse to apply the doctrine in *Furniss v Dawson*. A complete answer to that question is regrettably not to be found in an analysis of their Lordships' speeches. Here, the Realist school of jurisprudence comes into its own.

¹³

No relief may be available on A's death within seven years, on account of Inheritance Tax Act 1984 section 124A.