A In conclusion, my Lords, it seems to me that, unless the procedure adopted by the moving party is ill suited to dispose of the question at issue, there is much to be said in favour of the proposition that a court having jurisdiction ought to let a case be heard rather than entertain a debate concerning the form of the proceedings.

For the reasons already given I would dismiss this appeal.

B *Appeal dismissed with costs.*

Solicitors: Capsticks; Hempsons.

C. T. B.

C

D [HOUSE OF LORDS]

ENSIGN TANKERS (LEASING) LTD. . . . . . APPELLANT AND CROSS-RESPONDENT

AND

E STOKES (INSPECTOR OF TAXES) . . . . . RESPONDENT AND CROSS-APPELLANT

1992 Jan. 14, 15, 16, 20, 21, 22; March 12

Lord Keith of Kinkel, Lord Brandon of Oakbrook, Lord Templeman, Lord Goff of Chieveley and Lord Jauncey of Tullichettle

F *Revenue—Corporation tax—Capital allowances—Transactions carried out to obtain fiscal advantage—Company entering into limited partnerships to acquire master negatives of films—Expenditure by partnerships to acquire exclusive rights to completed films—Whether partnerships trading—Whether capital expenditure incurred by partnerships—Whether company entitled to first-year allowances—Finance Act 1971 (c. 68), s. 41(1)*

G During 1980 the taxpayer company and four other British companies as limited partners entered into partnership with the subsidiary of an American film production company as general partner to produce and exploit the film "Escape to Victory" then in course of production by the production company. The object of the British companies was to claim first year tax allowances under section 41(1) of the Finance Act 1971[1] in respect of the whole of the cost of the film. The partnership

H entered into agreements with the production company and its subsidiaries whereby the partnership contributed \$3·25m. (of which \$2·3m. represented the taxpayers' contribution) towards

[1] Finance Act 1971, s. 41(1): see post, p. 661D–E.

the cost of the film and became entitled to the master negative of the film and the production company agreed to complete the film and to lend to the partnership the cost in excess of \$3·25m. of making the film. The loans were non-recourse and were only repayable out of 75 per cent. of the net receipts from the exploitation of the film. The remaining 25 per cent. of the net receipts was received by the partnership. The taxpayer appealed against the refusal of the inspector of taxes to allow its claim to first year allowances based on the cost of the film amounting to \$14m. The special commissioners dismissed the taxpayer's appeal holding that the transactions entered into by the partnership had fiscal motives as a paramount object and as such were not a trading transaction.

Millett J. allowed the taxpayer's appeal on the grounds that the commissioners had misdirected themselves, their conclusions could not be supported and that the only true and reasonable conclusion on the facts was that the partnership was trading. The judge further held that the facts did not support alternative contentions raised by the revenue that for the purposes of section 41(1) of the Act of 1971 the master negative never "belonged" to the partnership, that only 25 per cent. of the expenditure was "incurred" by the partnership on the provision of plant and that the transactions had no commercial purpose other than the avoidance of tax and should thus be disregarded. The Court of Appeal allowed the revenue's appeal but remitted the case to the commissioners to decide, applying the tests stated, whether the taxpayer was or was not trading.

On appeal by the taxpayer and cross-appeal by the revenue:—

Held, allowing the appeal in part, that, analysing the transactions entered into as a single composite transaction regarded as a whole the legal effect was a trading transaction whereby the partnership expended \$3·25m. (but not \$14m.) towards the production and commercial exploitation of the film in which they had a 25 per cent. interest and generated a first-year allowance of \$3·25m. within section 41(1) of the Act of 1971; and that, accordingly, the case should be remitted to the commissioners for assessment of tax on that basis, in default of agreement (post, pp. 660H–661B, 675A–C, 676H–677A, C–F, 680A–C, 682D, 684C–D, 686C).

Dictum of Lord Keith of Kinkel in *Craven v. White (Stephen)* [1989] A.C. 398, 479, H.L.(E.) applied.

Inland Revenue Commissioners v. Duke of Westminster [1936] A.C. 1, H.L.(E.) explained.

Lupton v. F.A. & A.B. Ltd. [1972] A.C. 634, H.L.(E.) distinguished.

W.T. Ramsay Ltd. v. Inland Revenue Commissioners [1982] A.C. 300, H.L.(E.) considered.

Decision of the Court of Appeal [1991] 1 W.L.R. 341 varied.

The following cases are referred to in their Lordships' opinions:

Black Nominees Ltd. v. Nicol (1975) 50 T.C. 229

Chinn v. Hochstrasser [1981] A.C. 533; [1981] 2 W.L.R. 14; [1981] 1 All E.R. 189; 54 T.C. 311, H.L.(E.)

Coates v. Arndale Properties Ltd. [1984] 1 W.L.R. 1328; [1985] 1 All E.R. 15, H.L.(E.)

Commissioner of Inland Revenue v. Challenge Corporation Ltd. [1987] A.C. 155; [1987] 2 W.L.R. 24, P.C.

A *Craven v. White (Stephen)* [1989] A.C. 398; [1988] 3 W.L.R. 423; [1988] 3 All E.R. 495; 62 T.C. 1, H.L.(E.)
Floor v. Davis [1978] Ch. 295; [1978] 3 W.L.R. 360; [1978] 2 All E.R. 1079; 52 T.C. 609, C.A.
Furniss v. Dawson [1984] A.C. 474; [1984] 2 W.L.R. 226; [1984] 1 All E.R. 530; 55 T.C. 324, H.L.(E.)
Inland Revenue Commissioners v. Burmah Oil Co. Ltd. (1981) 54 T.C. 200,
B H.L.(Sc.)
Inland Revenue Commissioners v. Duke of Westminster [1936] A.C. 1, H.L.(E.)
Iswera v. Commissioner of Inland Revenue [1965] 1 W.L.R. 663, P.C.
Lupton v. F.A. & A.B. Ltd. [1972] A.C. 634; [1971] 3 W.L.R. 670; [1971] 3 All E.R. 948; 47 T.C. 580, H.L.(E.)
Overseas Containers (Finance) Ltd. v. Stoker [1987] 1 W.L.R. 1521; 61 T.C. 473; [1989] 1 W.L.R. 606; 61 T.C. 473, C.A.
C *Ramsay (W.T.) Ltd. v. Inland Revenue Commissioners* [1979] 1 W.L.R. 974; [1979] 3 All E.R. 213, C.A.; [1982] A.C. 300; [1981] 2 W.L.R. 449; [1981] 1 All E.R. 865; 54 T.C. 101, H.L.(E.)
Reed v. Nova Securities Ltd. [1985] 1 W.L.R. 193; [1985] 1 All E.R. 686; 59 T.C. 516, H.L.(E.)
Religious Tract and Book Society of Scotland v. Forbes (1896) 3 T.C. 415
Simmons (as liquidator of Lionel Simmons Properties Ltd.) v. Inland
D *Revenue Commissioners* [1980] 1 W.L.R. 1196; [1980] 2 All E.R. 798; 53 T.C. 461, H.L.(E.)

The following additional cases were cited in argument:

Baker v. Cook [1937] 3 All E.R. 509; 21 T.C. 337
Brighton College v. Marriott [1926] A.C. 192, H.L.(E.)
Coren v. Keighley [1972] 1 W.L.R. 1556; 48 T.C. 370
E *Customs and Excise Commissioners v. Faith Construction Ltd.* [1990] 1 Q.B. 905; [1989] 3 W.L.R. 678; [1989] 2 All E.R. 938, C.A.
Finsbury Securities Ltd. v. Inland Revenue Commissioners [1966] 1 W.L.R. 1402; [1966] 3 All E.R. 105; 43 T.C. 591, H.L.(E.)
Griffiths v. J. P. Harrison (Watford) Ltd. [1963] A.C. 1; [1962] 2 W.L.R. 909; [1962] 1 All E.R. 909, H.L.(E.)
Inland Revenue Commissioners v. Incorporated Council of Law Reporting
F (1888) 3 T.C. 105
Inland Revenue Commissioners v. Livingston (1926) 11 T.C. 538
Lord Advocate v. Gibb (1906) 5 T.C. 194
Newstead v. Frost [1978] 1 W.L.R. 511; [1978] 2 All E.R. 241
Newton v. Commissioner of Taxation of the Commonwealth of Australia [1958] A.C. 450; [1958] 3 W.L.R. 195; [1958] 2 All E.R. 759, P.C.
Quistclose Investments Ltd. v. Rolls Razor Ltd. [1970] A.C. 567; [1968]
G 3 W.L.R. 1097; [1968] 3 All E.R. 651, H.L.(E.)
Ransom v. Higgs [1974] 1 W.L.R. 1594; [1974] 3 All E.R. 949; 50 T.C. 1, H.L.(E.)
Reed v. Young [1986] 1 W.L.R. 649; 59 T.C. 196, H.L.(E.)
Royal Agricultural Society of England v. Wilson (1924) 9 T.C. 62
Stubart Investments Ltd. v. The Queen (1984) 10 D.L.R. (4th) 1
Thomson v. Gurneville Securities Ltd. [1972] A.C. 661; [1971] 3 W.L.R.
H 692; [1971] 3 All E.R. 1071; 47 T.C. 633, H.L.(E.)

APPEAL from the Court of Appeal.

This was an appeal by the taxpayer, Ensign Tankers (Leasing) Ltd., by leave of the Court of Appeal, from an order dated 30 January 1991 of that court (Sir Nicolas Browne-Wilkinson V.-C. and Stuart-Smith and Leggatt L.JJ.) [1991] 1 W.L.R. 341 allowing the revenue's appeal from an order dated 14 July 1989 of Millett J. [1989] 1 W.L.R. 1222, who had allowed the taxpayer's appeal by way of case stated from a decision by the Commissioners for the Special Purposes of the Income Tax Acts. The commissioners had decided that the taxpayer was not entitled to claim first year allowances under section 41(1) of the Finance Act 1971 for its share of certain capital expenditure incurred (or allegedly incurred) by two limited partnerships of which it was a member and which were said to have been trading partnerships.

The revenue cross-appealed.

The facts are stated in the opinion of Lord Templeman.

John Gardiner Q.C. and *Jonathan Peacock* for the taxpayer. When considering whether a particular transaction effected by a taxpayer constitutes a trade a two-stage test has to be applied. (1) Whether, considered objectively, the transaction has the outward appearance of a trading transaction: *Inland Revenue Commissioners v. Livingston* (1926) 11 T.C. 538, 542, 545. (2) If so, whether it can be said that the transaction has a non-commercial, or fiscal, object such that it cannot constitute trade. Both are questions of fact for the tribunal of fact and must be answered by considering the transaction as a whole. [Reference was made to section 155(1) and (2) of the Income and Corporation Taxes Act 1970 and *Reed v. Young* [1986] 1 W.L.R. 649.]

To achieve a commercial (i.e. non-fiscal) object, a taxpayer is entitled to adopt the form of transaction which is most beneficial to him from a tax point of view, particularly where tax benefits of one form (e.g. capital allowances under section 41(1) of the Finance Act 1971) rather than another have been specifically conferred by Parliament. It would be strange if it were the law that a trader who is motivated to enter into transactions by tax benefits conferred by Parliament is not trading when he enters into those transactions. The motive or intention of the taxpayer is only relevant to the question of trade or investment where the transaction is ambiguous, e.g. the purchase and sale of assets which are capable of being investments: *Simmons (as liquidator of Lionel Simmons Properties Ltd.) v. Inland Revenue Commissioners* [1980] 1 W.L.R. 1196 and *Iswera v. Commissioner of Inland Revenue* [1965] 1 W.L.R. 663.

The only remaining question is whether a transaction can, because of the motives of a taxpayer, be regarded as a raid on the public purse. This must be answered objectively by looking to the nature and effect of the transaction itself. Motive is relevant only where fiscal or other non-commercial motivations so affect the nature of the trading transactions that they cease to be normal trading transactions: *Religious Tract and Book Society of Scotland v. Forbes* (1896) 3 T.C. 415. It is the object or purpose of the transactions themselves which falls to be judged: *Newton v. Commissioner of Taxation of the Commonwealth of Australia* [1958] A.C. 450, 465 and *Newstead v. Frost* [1978] 1 W.L.R. 511, 519. Either there is trade or there is no trade. There is no half way house of partial trade: *Ransom v. Higgs* [1974] 1 W.L.R. 1594.

A The revenue's claim that motive is a relevant factor in the
determination of the existence of a trade appears to be based on the
series of decisions generally known as the "dividend stripping cases:" see
Lupton v. F. A. & A. B. Ltd. [1972] A.C. 634; *Finsbury Securities Ltd.
v. Inland Revenue Commissioners* [1966] 1 W.L.R. 1402 and *Thomson
v. Gurneville Securities Ltd.* [1972] A.C. 661. But those cases only
establish that transactions the sole object of which is to manufacture a
B tax recovery claim cannot be trading transactions. The crucial distinction
is that in the present case a trading loss was not a certainty and profit
was not built into the transactions in advance at a fixed sum or rate.

Other transactions which have been held to be non-trading are
transactions between groups of companies with no money passing and
where assets are not acquired as stock in trade: see *Reed v. Nova
C Securities Ltd.* [1985] 1 W.L.R. 193 and *Overseas Containers (Finance)
Ltd. v. Stoker* [1989] 1 W.L.R. 606. [Reference was also made to *Coates
v. Arndale Properties Ltd.* [1984] 1 W.L.R. 1328.]

If the transactions effected by a taxpayer are of a commercial
character, whether trade or investment, then the taxpayer's motives are
irrelevant. Thus, a charity which acts from charitable or philanthropic
motives is nevertheless trading if its acts have a commercial character
D and a commercial object or purpose: see *Brighton College v. Marriott*
[1926] A.C. 192; *Inland Revenue Commissioners v. Incorporated Council
of Law Reporting* (1888) 3 T.C. 105 and *Royal Agricultural Society of
England v. Wilson* (1924) 9 T.C. 62.

A trading transaction does not cease to be such merely because it
involves a high degree of risk. [Reference was made to *Lord Advocate
E v. Gibb* (1906) 5 T.C. 194; *Baker v. Cook* [1937] 3 All E.R. 509 and
Stubart Investments Ltd. v. The Queen (1984) 10 D.L.R. (4th) 1.]

Christopher McCall Q.C. and *Launcelot Henderson* for the revenue.
The crucial question is whether the partnership was trading. There was
no trading. Consistently with *W. T. Ramsay Ltd. v. Inland Revenue
Commissioners* [1982] A.C. 300 and *Furniss v. Dawson* [1984] A.C. 474
there is no first-year allowance available to the taxpayer under section
F 41(1) of the Finance Act 1971. Partial trading is unknown to the law.
Either the partnership was trading or not; it is not possible to say that it
was trading but only to a limited extent.

Although motive is conceded to be irrelevant to the question whether
the partnership was trading, there is a fundamental difference between
intention and motive. Intention means seeking to do something and is
G linked to purpose, which is the same as object. The intention of the
taxpayer was to achieve the benefit of the first-year 100 per cent.
allowance under section 41(1). The transactions were specially entered
into for that purpose. Motive, on the other hand, relates to the reason
for doing something. The taxpayer's reason was to improve the tax
position of the taxpayer's group.

The transactions were not trading transactions. Trading requires an
H intention to trade: *Simmons (as liquidator of Lionel Simmons Properties
Ltd.) v. Inland Revenue Commissioners* [1980] 1 W.L.R. 1196 and
Iswera v. Commissioner of Inland Revenue [1965] 1 W.L.R. 663. The
question is whether an asset was acquired for the purpose of investment

or as stock in trade. To show trading the asset has to be acquired as stock in trade: *Reed v. Nova Securities Ltd.* [1985] 1 W.L.R. 193. If the object is to obtain a fiscal purpose the transaction is not trading: *Overseas Containers (Finance) Ltd. v. Stoker* [1989] 1 W.L.R. 606.

In dividend stripping cases it is difficult to apply the principle that one has to look at the transaction objectively: see *Lupton v. F. A. & A. B. Ltd.* [1972] A.C. 634, 646, 654 and *Thomson v. Gurneville Securities Ltd.* [1972] A.C. 661. In view of those decisions there is no need to overrule *Griffiths v. J. P. Harrison (Watford) Ltd.* [1963] A.C. 1. In the present case the question to be answered is whether the film was acquired for trading or fiscal purposes. [Reference was made to *Commissioner of Inland Revenue v. Challenge Corporation Ltd.* [1987] A.C. 155.]

The cross-appeal arises if the appeal is allowed because it will be necessary to determine the extent to which the taxpayer incurred expenditure in relation to the making of the films.

The taxpayer (and others) executed a series of interdependent agreements. In accordance with principles expressed in *W. T. Ramsay Ltd. v. Inland Revenue Commissioners* [1982] A.C. 300, 323–324, 326, 337–338 and in *Furniss v. Dawson* [1984] A.C. 474, 526, to ascertain what is within the meaning of "expenditure" for the purposes of section 41 of the Act of 1971 the agreements have to be construed as a whole. The answer can only be: to the extent of the 25 per cent. capital which was introduced by the limited partners and not to the extent of 75 per cent. of the expenditure which was nominally undertaken by the taxpayer.

Gardiner Q.C. on the cross-appeal, after referring to *Craven v. White (Stephen)* [1989] A.C. 398 in reply. There is no room for the principle in *Ramsay* and related authorities for the reasons given in the speech of Lord Oliver of Aylmerton in *Craven v. White.* Looking at it as a matter of ordinary principle, the revenue has assumed that under section 41(1) expenditure is not incurred until payment has been made. But the section is satisfied and expenditure is incurred either when a contract to purchase plant is made or, if later, when the sums due under the contract become payable. The actual payment or funding thereof however arranged is irrelevant. Since payment is not the operative event for section 41, the source of finance is irrelevant. *Coren v. Keighley* [1972] 1 W.L.R. 1556 shows that expenditure is incurred even in a case where a vendor of property acts, in the same transaction, in the capacity of lender. [Reference was made to *Quistclose Investments Ltd. v. Rolls Razor Ltd.* [1970] A.C. 567 and *Customs and Excise Commissioners v. Faith Construction Ltd.* [1990] 1 Q.B. 905.] The revenue's argument wholly confuses the taxpayer's obligations to pay for the films with their arrangements for funding the same.

McCall Q.C. replied.

Their Lordships took time for consideration.

March 12. LORD KEITH OF KINKEL. My Lords, I have read the speech to be delivered by my noble and learned friend, Lord Templeman, and I agree with it. For the reasons he gives, I would allow this appeal and make the orders for remit to the commissioners and for costs which he proposes.

LORD BRANDON OF OAKBROOK. My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Templeman. I agree with it and for the reasons which he gives I would dispose of the appeal and cross-appeal in the manner proposed by him.

LORD TEMPLEMAN. My Lords, this appeal is concerned with a tax avoidance scheme, a single composite transaction whereunder the tax advantage claimed by the taxpayer is inconsistent with the true effect in law of the transaction. In the present case the taxpayer claims for itself and its partners capital allowances for expenditure of $14m. although the partners were never liable to spend more than $3¼m. of their own money.

By section 41 of the Finance Act 1971 Parliament sought to encourage a British trader to spend capital on machinery or plant for the purposes of his trade. The encouragement took the form of allowing the trader in the computation of his income tax or corporation tax to deduct the expenditure from his profits in the year of expenditure.

Section 41(1) is in the following terms:

> "where (*a*) a person carrying on a trade incurs capital expenditure on the provision of machinery or plant for the purposes of the trade, and (*b*) in consequence of his incurring the expenditure, the machinery or plant belongs to him at some time during the chargeable period related to the incurring of the expenditure, there shall be made to him for that period an allowance (in this chapter referred to as 'a first year allowance') which shall be of an amount determined in accordance with section 42 below . . ."

In 1980 the master negative of a commercial film constituted plant for the purposes of this section and the first year allowance was 100 per cent.

In March 1980 Lorimar Productions Inc. ("L.P.I."), a Californian company engaged in the production of films, embarked on the production of "Escape to Victory." By an agreement dated 6 June 1980 Chemical Bank agreed to provide finance to make the film in the form of a revolving loan credit up to a maximum of $11m. repayable by L.P.I.

Guinness Mahon, a merchant bank specialising in the manufacture of tax avoidance schemes persuaded the appellant, Ensign Tankers (Leasing) Ltd., and four other British companies to participate in a scheme whereby they would contribute $3¼m. to the cost of making the film "Escape to Victory" in return for 25 per cent. of the net receipts from the exploitation of the film and whereby, so they were advised, they would be entitled to a first year allowance equal to the total cost of the film. The scheme procured for L.P.I. the sum of $3¼m. plus various substantial production and distribution fees and interest and 75 per cent. of the net receipts from the exploitation of the film. The scheme was a single composite transaction embodied in 17 documents all of which are dated 14 July 1980. The appellant accepts that all the documents which constituted the scheme must be read as a whole. For present purposes some only of the documents need to be considered. A

A partnership agreement was made between Victory Films Productions Ltd. ("Victory Productions"), as general partner and the five British companies as limited partners. The partnership was called "Victory Partnership" and its objects were to carry on in the United Kingdom the B business of making and distributing films. The capital of the partnership was $3¼m. contributed by the limited partners including $2,375,800 contributed by the appellant. Under the Limited Partnerships Act 1907 and by the express terms of the partnership agreement the limited partners were not liable for the debts and obligations of the partnership beyond the capital they had contributed and were not entitled to take C part in the management of the partnership or to bind the partnership. The management of the partnership was in the hands of Victory Productions which was a wholly owned subsidiary of L.P.I.

By a rights agreement, L.P.I. granted Victory Partnership in consideration of $1 the exclusive licence to make and exploit the film "Escape to Victory" throughout the world for the entire period of copyright. D

By clause 6 of a production services agreement, L.P.I. agreed to make the film "Escape to Victory" in Hungary or elsewhere as L.P.I. should decide in accordance with an approved budget of $12,996,502 but on behalf of Victory Partnership. By clauses 6 and 17 the approved budget included the sum of $4,780,951 which had already been spent by L.P.I. in making the film. By clause 7, Victory Partnership agreed to E provide the finance required for the approved budget and L.P.I. agreed to provide the finance required to complete the film if the costs exceeded the approved budget. By clause 13, L.P.I. assigned to Victory Partnership the film negative which had already been shot and the right to the complete film negative as and when the film was continued and completed.

By a loan agreement, Victory Partnership agreed to provide $3¼m. F towards the cost of the film and L.P.I. agreed to lend Victory Partnership $9¾m. ("the production loan") required to provide the balance of the cost of the approved budget and also to lend to Victory Partnership the amount required ("the completion loan") to complete the film if, in the event which happened, the film cost more than $13m. Clause 1.2 of the Loan Agreement required Victory Partnership to maintain a current account G ("the scheme current account") with a bank designated by L.P.I., and to pay into that account all advances by L.P.I. Withdrawals from the scheme current account required the concurrence of a person designated by L.P.I. The scheme current account was maintained with Guinness Mahon. The film cost $14m. so that the production loan of $9¾m. was supplemented by the completion loan of $1m. By clause 1.7 it was agreed that until Victory Partnership had received the sum of $3¼m. H from 25 per cent. of the net receipts from the exploitation of the film, an amount equal to 75 per cent. of the net receipts should be applied towards repayment of the production loan. Thereafter all the net

A receipts were to be applied in repayment of the production loan and the completion loan and interest thereon. Clause 1.11 of the loan agreement, however, entitled "non-recourse loan," freed and discharged Victory Partnership and all the partners of Victory Partnership from any liability to repay the production loan or the completion loan or interest or any other moneys which became due to L.P.I. under the terms of the loan agreement.

B By a distribution agreement and by a U.K. agency (Firrilee) agreement, Victory Partnership vested in Lorimar Distribution International Inc. and Firrilee Ltd. ("the distributors"), two wholly owned subsidiaries of L.P.I., the exclusive right to distribute and exploit the film "Escape to Victory" throughout the world in perpetuity. The distributors were authorised to pay the costs of distributing and exploiting
C the film and to retain percentage fees out of the receipts from the exploitation of the film. By clause 11 the distributors were directed to pay 100 per cent. of the net receipts from the exploitation of the film to Victory Partnership until Victory Partnership had received an amount equal to the production loan and the completion loan plus interest at the rate prescribed by the loan agreement. Thereafter the distributors were to retain 75 per cent. of the net receipts and to pay 25 per cent. to
D Victory Partnership. In the event the net receipts from the exploitation of the film have so far amounted to \$12m., that is \$2m. less than the cost of the film.

By a letter addressed by Victory Partnership to and accepted by the distributors and agreed and accepted by L.P.I., the provision in clause 11 of the distribution agreement providing for 100 per cent. of the net
E receipts from the exploitation of the film to be paid to Victory Partnership was replaced by an irrevocable authority and direction to the distributors to pay 25 per cent. of the net receipts to Victory Partnership and to pay 75 per cent. of the net receipts to L.P.I. until Victory Partnership had received \$3¼m. Thereafter 100 per cent. of the net receipts from the exploitation of the film were to be paid to L.P.I. until L.P.I. had received an amount equal to the production loan, the
F completion loan and interest and other moneys payable under the loan agreement. Thereafter 75 per cent. of the net receipts were to be retained by the distributors and 25 per cent. were to be paid over to Victory Partnership.

By a waiver and consent, Chemical Bank which, as will appear, was to receive the benefit of the payment of \$3¼m. by Victory Partnership in
G reduction of its loan to L.P.I., agreed to the documents I have outlined and thereby reduced its security to the amounts of the net receipts from the exploitation of the film from time to time payable to L.P.I.

On 24 July 1980 the scheme current account was duly opened with Guinness Mahon in the name of Victory Partnership. On 25 July 1980 \$3¼m. was credited to that account from the limited partners of Victory Partnership in the amounts of their contributions to the partnership
H capital. That sum was remitted to L.P.I. on the same date and thence to Chemical Bank.

On 31 July 1980 the sum of \$1,530,951 was paid into the scheme current account by L.P.I. and on the same day that sum was returned to

L.P.I. by way of a credit to its account at Chemical Bank. The sums of A
$1,530,951 and $3¼m. amounted to the costs incurred by L.P.I. in making the film before 14 July 1980 namely $4,780,951 as appears from clauses 6 and 17 of the production services agreement. In the result by the end of July Victory Partnership had paid $3¼m. to L.P.I. The sum of $1,530,951 had been paid by L.P.I. into the scheme current account and promptly transferred back to L.P.I. and the debt owed by L.P.I. to Chemical Bank had been reduced by $3¼m. Thereafter, when L.P.I. B
required to spend or spent money in making the film, the amount involved was credited by L.P.I. to the scheme current account (which was controlled by L.P.I.) and returned to L.P.I. on the same day for credit to its account at Chemical Bank. The scheme current account was thus never in credit or debit at the close of any day and Victory Partnership was never in debt as a result of the scheme. The cost of the C
film, namely $14m. was borne as to $3¼m. by Victory Partnership and as to $10¾m. by L.P.I. which was indebted to Chemical Bank for that amount.

In March 1982 the distributors became accountable for receipts from the exploitation of the film as a result of contracts entered into by the distributors with cinema and television operators. Pursuant to the scheme, 75 per cent. of the net receipts were paid to L.P.I. and 25 per D
cent. to Victory Partnership. Although the film had cost $14m., the net receipts from the exploitation of the film have so far only amounted to $12m. and further receipts are not anticipated. Victory Partnership, having paid $3¼m. towards the cost of the film, has received 25 per cent. of the net proceeds amounting to $3m. L.P.I., having paid $10¾m. towards the cost of the film, has received 75 per cent. of the net receipts E
or $9m. No one is liable to pay L.P.I. anything in the future save the distributors if and so far as they receive further moneys from the exploitation of the film.

Victory Partnership in the tax year 1980 to 1981 incurred capital expenditure amounting to $3¼m. in the provision of plant, namely the film. The negative belonged to Victory Partnership subject to the exclusive rights of exploitation vested in the distributors and there also F
belonged to Victory Partnership 25 per cent. of the net receipts from the exploitation of the film. In these circumstances Victory Partnership fulfilled all the conditions necessary to generate a first year allowance of $3¼m. provided that the expenditure of that amount was incurred for the purposes of a trade carried on by Victory Partnership namely the production and distribution of the film "Escape to Victory." G

By section 155 of the Income and Corporation Taxes Act 1970 the benefit of any first year allowance generated by Victory Partnership in connection with the cost of the film "Escape to Victory" accrued to the appellant and the four other British limited partners of Victory Partnership in the proportions in which they respectively contributed to the capital of the partnership. The appellant having contributed $2,375,800 to the partnership capital of $3¼m. is entitled to a first year H
allowance of $2,375,800.

The appellant, disputing this analysis, claimed that Victory Partnership had generated a first year allowance of $14m. being the total cost of the

A film. That claim was rejected by the commissioners on the grounds that in its activities with regard to the film "Escape to Victory," Victory Partnership was not carrying on a trade but was carrying out a device to avoid tax. Millett J. [1989] 1 W.L.R. 1222 disagreed with the commissioners and decided that the activities of Victory Partnership with regard to the film constituted the trade of making and exploiting
B films and decided also that Victory Partnership had incurred capital expenditure of $14m. for the purposes of section 41 of the Act of 1971. The Court of Appeal (Sir Nicolas Browne-Wilkinson V.-C. and Stuart-Smith and Leggatt L.JJ.) [1991] 1 W.L.R. 341 reversed the decision of Millett J. but referred the dispute back to the commissioners to decide whether, applying the tests indicated by the Court of Appeal, Victory Partnership was or was not trading. The appellant appeals and asks for
C the order of Millett J. to be restored. The respondent inspector of taxes argues that Victory Partnership did not generate any first year allowance because Victory Partnership was not engaged in trade. Alternatively, by cross-appeal, the revenue contend that any first year allowance generated by Victory Partnership is limited to the sum of $3¼m.

D The parties agree that the 17 documents dated 14 July 1980 were interdependent, and constituted one single composite agreement or transaction, which was a tax avoidance scheme and must be read as a whole.

If the documents constituting the scheme are read as a whole, the rights of Victory Partnership under the scheme are the rights which were and remained vested in Victory Partnership after all the documents had
E been signed. Similarly the obligations of Victory Partnership under the scheme are the obligations which were and remained enforceable against Victory Partnership after all the documents had been signed. The financial consequences to Victory Partnership of the scheme are the consequences which flowed from the rights conferred and the obligations imposed on Victory Partnership. The taxation allowances and taxation
F liabilities of Victory Partnership are the allowances and liabilities which, pursuant to the taxing statutes, are applicable to the financial consequences.

When all the documents had been entered into, Victory Partnership was subject to an obligation to pay $3¼m. to L.P.I. and subject to an obligation whereby any money paid by L.P.I. into the scheme current
G account was immediately transferred back to L.P.I. The financial consequence to Victory Partnership of its obligations under the scheme was the expenditure by Victory Partnership of $3¼m. When all the documents had been entered into, Victory Partnership had a right to 25 per cent. of the net receipts from the exploitation of the film. The financial consequence to Victory Partnership of its rights under the scheme was the receipt by Victory Partnership of $3m., being 25 per
H cent. of the net receipts from the film. The taxation consequences were that Victory Partnership, provided it were trading, generated a first year allowance of $3¼m. and Victory Partnership became in due course liable to corporation tax on the profits of $3m. which it received.

Mr. Gardiner submitted on behalf of the appellant, as he had A
successfully submitted to Millett J., that Victory Partnership carried on the trade of producing and distributing films in connection with "Escape to Victory" and that Victory Partnership incurred capital expenditure of the cost of the film namely \$14m. between July 1980 and March 1982 when the film was completed. The negative of the film belonged to Victory Partnership between 14 July 1980 and March 1982 and therefore Victory Partnership generated under section 41 of the Act of 1971 first B
year allowances amounting in the aggregate to \$14m.

Mr. Gardiner said that the 17 documents were not sham documents and that the parties to the scheme were free to enter any transaction in any form they pleased. A taxpayer who chooses a form of transaction which reduces his burden of tax is not to be criticised or punished or deprived of that reduction in tax which his ingenuity has achieved. Mr. C
Gardiner said further that by the scheme Victory Partnership purchased the film for \$$3\frac{1}{4}$m., spent \$$10\frac{3}{4}$m. completing the film with money borrowed from L.P.I. and repaid \$9m. of the loan to L.P.I. by directing the distributors to pay to L.P.I. 75 per cent. of the net proceeds which arose from the exploitation of the film. But as I have indicated, Victory Partnership only expended \$$3\frac{1}{4}$m. and was never liable to pay more. L.P.I. had no right to recover from Victory Partnership or anyone else D
any part of the moneys expended by L.P.I. on the film. L.P.I. did not partially recoup the production loan and the completion loan of \$$10\frac{3}{4}$m. out of 75 per cent. of the net receipts from the exploitation of the film any more than Victory Partnership recouped a loan of \$$3\frac{1}{4}$m. out of 25 per cent. of the net receipts. Victory Partnership paid \$$3\frac{1}{4}$m. towards the cost of the film and received 25 per cent. of the net receipts. L.P.I. E
paid \$$10\frac{3}{4}$m. towards the costs of the film and received 75 per cent. of the net receipts. If 75 per cent. of the net receipts had produced exactly \$$10\frac{3}{4}$m. that would have been a miraculous coincidence but would not have changed the expenditure incurred by L.P.I. in making the film into a loan to Victory Partnership.

In the course of his judgment Millett J. said [1989] 1 W.L.R. 1222,
1228: F

> "In purely financial terms, Victory Partnership was in effect a sleeping partner with a minority interest. It was putting up 25 per cent. of the cost and taking a 25 per cent. equity participation. L.P.I. was putting up the remaining 75 per cent. of the cost and its associated company was retaining a 75 per cent. participation."

G

This statement is not wholly accurate. Victory Partnership did not put up 25 per cent. of the cost but only \$$3\frac{1}{4}$m. L.P.I. did not put up 75 per cent. of the cost but the whole of the cost of \$14m. in excess of \$$3\frac{1}{4}$m. The associated company did not retain a 75 per cent. participation. In the events which happened, the participation was that of L.P.I. which was entitled to receive and did receive 75 per cent. of the net receipts amounting to \$9m. Allowing for these inaccuracies the judge was quite H
right in his analysis of the true legal effect of the transaction. The transaction was a joint venture and contained no element of loan. That analysis leads to two conclusions. First, upon the true construction of

the 17 documents dated 14 July 1980 read as a whole the only expenditure of Victory Partnership for the purposes of section 41 of the Act of 1971 or for any other purpose for that matter amounted to \$3¼m. and no more. Secondly, the 17 documents do indeed incorporate a tax avoidance scheme, that is to say, a single composite transaction whereunder the tax advantage claim by the taxpayer, namely a first year allowance of \$14m., is inconsistent with the consequence of the transaction, in this case the expenditure of \$3¼m. Unfortunately, the judge continued as follows:

> "In legal terms, however, L.P.I. was not an equity participant, for it was making its contribution by way of loan. But a loan creditor would normally expect to be repaid before equity participants recovered any part of their capital, whereas L.P.I.'s advance was recoverable only out of film receipts and was repayable pari passu with instead of ahead of Victory Partnership's capital investment. In these circumstances, the retention of a 75 per cent. participation in the profits by the loan creditor or its associated company is not difficult to justify."

This analysis ignores the fact that by reason of the non-recourse provision of the loan agreement, the loan was not repayable by Victory Partnership or any one else. A creditor who receives a participation in profits *in addition* to repayment of his loan is of course a creditor. But a creditor who receives a participation in profits *instead of* repayment of his "loan" is not a creditor. The language of the document in the latter case does not accurately describe the true legal effect of the transaction which is a capital investment by the "creditor" in return for a participation in profits.

In a later passage Millett J. said, at p. 1230:

> "The non-recourse nature of the borrowing and the use of the limited partnership (either of which would have been sufficient without the other) provided a desirable protection for participants but were not necessary to the securing of the tax advantages sought to be obtained."

But the non-recourse nature of the borrowing ensured that L.P.I. paid the whole cost of the film exceeding \$3¼m. and conversely that Victory Partnership would not be liable for the cost of the film in excess of \$3¼m. By the operation of the scheme current account in accordance with the provisions of the scheme, the money of L.P.I., at all times under the control of L.P.I., was electronically transferred from Hollywood to the City of London and back again without serving any useful purpose and leaving no trace except entries on computer prints. The scheme is one of many; it reflects no credit on Guinness Mahon, the merchant bank which invented it, or on the appellant and the other industrial companies which purchased it for many hundreds of thousands of pounds. If successful, the scheme would have been operated at the expense of the British public and, whether successful or unsuccessful, involved the exploitation of British capital allowances for the making of a foreign film.

Mr. Gardiner sought to escape from the legal, financial and taxation A consequences of the true effect in law of the scheme documents read as a whole by submitting that a taxpayer may enter into a transaction in any form he chooses and that the court is not entitled to ignore or contradict the form of the transaction. In the present case the transaction took the form of a purchase of the film by Victory Partnership and the completion of the film by L.P.I. as agent for Victory Partnership with money borrowed from L.P.I. on terms that the B borrowing would only be repayable out of 75 per cent. of the net receipts from the film. The form of the transaction was admittedly designed to avoid tax. But there is no morality in a tax and no illegality or immorality in a tax avoidance scheme. The taxpayer may reduce his income tax by giving away income bearing property; by entering into a covenant to make payments to a charity for four years if he so long C lives; by selling high-yielding gilt-edged stock and purchasing equities which produce a low income; a self-employed person may reduce his income tax by paying a premium for a self-employed pension; a trader company may save corporation tax by incurring capital expenditure on plant or machinery for the purpose of its trade; a taxpayer, it is submitted, may also save tax by participating in a tax avoidance scheme. If the scheme takes the form of a purchase, development and borrowing D by the taxpayer and even if the borrowing is not repayable, the revenue cannot impose another form of transaction on the taxpayer by analysing the rights and obligations conferred and imposed by the scheme and charging tax as if the scheme had taken the form of a purchase of a limited interest in consideration of a contribution to cost.

The revenue on the other hand argue that a tax avoidance scheme is E ineffective and taints any transaction involved in the scheme. In the present case Victory Partnership entered into a scheme with the object of avoiding tax and not with the object of trading. In the course of the scheme Victory Partnership contributed $3¼m. to the cost of the film and became entitled to 25 per cent. of the net receipts; that transaction in isolation would admittedly constitute trading in the making and exploiting of films. But the transaction was only part of a tax avoidance scheme. F It follows therefore that the conditions of section 41 of the Act of 1971 are not fulfilled. In relation to "Escape to Victory" Victory Partnership did not carry on a trade and did not incur capital expenditure for the purposes of a trade; Victory Partnership did not generate any first year allowance. The commissioners accepted these submissions. The Court of Appeal referred the case back to the commissioners to decide whether G the agreement reached on 14 July 1980 "was in reality merely a device to secure a fiscal advantage or a genuine trading activity:" *per* Sir Nicolas Browne-Wilkinson V.-C. [1991] 1 W.L.R. 341, 357.

There are therefore two rival submissions. Mr. Gardiner submits that the taxpayer may enter into any transaction in any form he pleases and the court is confined to that form and cannot have regard to the rights and obligations which flow from the transaction because the court H cannot consider the substance of the transaction. The revenue on the other hand appear to look upon tax avoidance as a corporate cancer which infects and destroys any fiscal effect advantageous to the taxpayer.

A In the present case although the contribution by Victory Partnership to
the cost of the film of the sum of $3¼m. in consideration for 25 per cent.
of the net receipts from the exploitation of the film can only be
described as trading, Victory Partnership did not generate a first year
allowance of $3¼m. because the trading was part of a tax avoidance
scheme designed to procure a first year allowance of $14m.

The resolution of this dispute requires an examination of the
B principles and authorities dealing with tax avoidance schemes. Oliver
Wendell Holmes once said that taxation is the price which we pay for
civilisation. Lord Tomlin said in *Inland Revenue Commissioners v. Duke of Westminster* [1936] A.C. 1, 19 that "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."

C In the *Westminster* case, the Duke entered into a covenant to pay an
annuity to his gardener who volunteered that while he continued to be
employed by the Duke he would be content with the annuity plus such
sum as might be necessary to make up his wages.

In the *Westminster* case there were two rival explanations of the
transactions between the Duke and his gardener. The first explanation
is that the gardener voluntarily worked full-time for the Duke for half
D wages and enjoyed the annuity given to him by the Duke. This
explanation was accepted by the majority. Lord Atkin however in his
dissenting speech pointed out, at pp. 10–11, that assuming the gardener
was content to draw half wages, the Duke would remain at all times
liable to pay to the gardener the arrears of the contractual wages.

> "However long a time the service continued, the servant would be
> E entitled to this sum within the limit, if the Duke of Westminster
> chose to plead the Statute of Limitations, of six years' arrears. The
> arrears would be a debt due to the servant and could be attached
> by any creditor of the servant, and would on death be assets of his
> which his personal representative would be bound to recover . . .
> peculiar results might follow if the wages were regulated by statute
> F as by the Agricultural Wages Act or similar legislation. . . . A nice
> question might arise as to the amount which the Duke would be
> bound to tender as wages in lieu of notice. The embarrassments
> however, are not all on the Duke's side."

The gardener would incur liability for income tax for wages that he was
entitled to but voluntarily omitted to draw.

G The second explanation of the facts in the *Westminster* case is that
the gardener worked full time for full wages and volunteered or agreed
that he would not take his annuity until he had retired. Lord Atkin
thought that this was the true effect in law on the facts. I agree with
Lord Atkin; gardeners do not work for Dukes on half-wages.

If, however, as the majority of the House concluded, the gardener
H voluntarily declined to accept half his wages but accepted the whole of
his annuity, the financial consequences to the Duke were that he paid
the annuity and the taxation consequences were that he was entitled to
deduct the amount paid in computing his liability to income tax and
surtax. The dictum of Lord Tomlin, applied to the obligations of the

Duke, is not inconsistent with later authority. But if the dictum of Lord Tomlin implied that any tax avoidance scheme which was not a sham and not unlawful must be allowed to succeed, subsequent authorities have determined otherwise. The *Westminster* case does not assist the appellant in the present case. In the *Westminster* case the fiscal consequences claimed by the Duke corresponded to the legal consequences of the transaction as construed by the majority of this House. In the present case the fiscal consequences claimed by the appellant do not correspond to the legal consequences of the scheme documents read and construed as a whole.

In the last two decades there have been a number of tax avoidance schemes which have proved unsuccessful despite the taxpayers' reliance on the dictum and decision in the *Westminster* case.

In *Lupton v. F.A. & A.B. Ltd.* [1972] A.C. 634 the tax avoidance scheme took the form of dividend-stripping; the House considered the scheme as a whole and declined to allow the taxpayer a fiscal result which did not correspond to the financial result. In the typical dividend-stripping case, a trader in shares purchases for £100 shares pregnant with dividend. There is then declared a dividend of £80 and the dealer sells the shares for £20, that being their value once the dividend has been paid out. The dealer then asserts that he has made a loss in his trade of purchasing and selling the shares because he has bought at £100 and sold at £20. This assertion ignores the dividend he has received. In *Lupton's* case the dealer was not allowed to succeed in a claim for a fiscal loss of £80 because, viewing the transaction as a whole, and taking the dividend into account he had made no loss at all. Viscount Dilhorne said, at p. 657:

> "if a transaction viewed as a whole is one entered into and carried out for the purpose of establishing a claim against the revenue . . . I for my part would have no hesitation in holding that it does not form part of the trading activities of a dealer in stocks and shares. When I say 'viewed as a whole,' I mean that regard must be had not only to the inception of the transaction, to the arrangements made initially, but also to the manner of its implementation."

Lord Donovan said, at p. 657, that the shares had been bought pursuant to a plan having as its objects:

> "to provide the appellants with an opportunity to compel the revenue to pay to them a large sum of money which they, the appellants, had never themselves disbursed in tax . . . I say that this is not trading in stocks and shares. If I am asked what it is, I would reply that it is the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons."

Mr. McCall, on behalf of the revenue, relied heavily on *Lupton's* case because this House held that tax avoidance is not trading. Therefore, Mr. McCall submitted, the tax avoidance scheme in the present case is not trading and Victory Partnership did not create any valid claim to a first year allowance although Victory Partnership

A incurred expenditure of $3¼m. in the production of a film. I see the force of the argument. The precedent of *Lupton's* case was followed by the Court of Appeal in the instant case. But in dividend-stripping cases the tax avoidance scheme negatives trading because on the true analysis of the transaction the trader does not trade at all. In *Lupton's* case where there was neither a profit nor a loss the House did not consider the present situation in which on the true analysis there was trading B involving an expenditure of $3¼m. The financial consequences of the scheme namely the expenditure by Victory Partnership of $3¼m. on the making of a film, produce the corresponding fiscal consequence of a first year allowance of that sum. The task of the courts is to construe documents and analyse facts and to ensure the taxpayer does not pay too little tax or too much tax but the amount of tax which is consistent C with the true effect in law of the taxpayer's activities. Neither the taxpayer nor the revenue should be deprived of the fiscal consequences of the taxpayer's activities properly analysed.

In *Black Nominees Ltd. v. Nicol* (1975) 50 T.C. 229, a tax avoidance scheme which employed a number of companies, settlements and agreements for the purpose of apparently converting the taxable earnings of an actress into non-taxable instalments of capital in her hands was D held by me to be ineffective to relieve the actress from paying tax in common with other earners. The true effect in law of the scheme was that the actress enjoyed her earnings.

In *Floor v. Davis* [1978] Ch. 295, 312, Eveleigh L.J. in a dissenting judgment, held that capital gains tax was payable under a scheme which exploited the control of the taxpayer of companies at home and abroad E to conclude a number of transactions which, taken separately, appeared to escape tax.

In *W.T. Ramsay Ltd. v. Inland Revenue Commissioners* [1979] 1 W.L.R. 973, 979, I pointed out that most tax avoidance schemes involve play acting. In the present case the operation of the Scheme Current Account amounted to play acting.

The decisive stage in the development of this field of revenue law F came with the decision of this House in *Chinn v. Hochstrasser* [1981] A.C. 533. That case, unlike the dividend-stripping cases, did not involve the concept of trading. The case concerned capital gains tax. Tax was payable on a distribution of a trust asset by a trustee to a beneficiary on the difference between the price paid by the trustees originally and the value of the asset at the time of its transfer to the G beneficiary. On the other hand the purchase price paid for an asset by a purchaser of that asset from a foreign company was not liable to capital gains tax. In *Chinn v. Hochstrasser* trustees were minded to appoint shares to a taxpayer beneficiary and a scheme was devised to avoid capital gains tax on the transaction. The trustees retired and were replaced by foreign trustees, an appointment was made of the shares to the taxpayer contingent on his surviving by three days and the taxpayer H sold his reversionary interest to a foreign company. The taxpayer then purchased the shares from the company. The revenue claimed capital gains tax on the grounds that the shares had been disposed of to a beneficiary. The taxpayer claimed that he had purchased the shares.

This House, reversing the Court of Appeal, held that upon the true (A) construction of the documents the trustees had disposed of the shares to a beneficiary In the present case Victory Partnership claims to be a borrower of $10¾m. and to have expended the sum borrowed in making a film. However, upon the true construction of the documents Victory Partnership was not a borrower and expended $3¼m. only. In *Chinn v. Hochstrasser* this House treated all the documents in the transactions carried out by the taxpayer as one single composite transaction, read the (B) documents as a whole and applied the taxing statutes to the true legal effect of the transaction, ignoring the sale of the contingent reversionary interest and the purchase of the shares which were in effect self-cancelling. The consequence of the transaction in *Chinn v. Hochstrasser* was the acquisition by the taxpayer of the shares as a beneficiary. In the present case the loan by L.P.I. deposited in the Scheme Current (C) Account followed immediately by payment out of that account back to L.P.I. were two self-cancelling operations. The true legal effect of the transaction as a whole were that Victory Partnership expended $3¼m. and no more. In my opinion the submissions of Mr. Gardiner in the present case are inconsistent with the decision of this House in *Chinn v. Hochstrasser*.

A similar result was reached in *W.T. Ramsay Ltd. v Inland Revenue* (D) *Commissioners* [1982] A.C. 300, which approved *Black Nominees Ltd. v. Nicol*, 50 T.C. 229, and the dissenting judgment of Eveleigh L.J. in *Floor v. Davis* [1978] Ch. 295, 312.

In *Ramsay's* case a taxpayer who had incurred a liability for capital gains tax entered into two transactions whereby he made an allowable loss matched by a non-chargeable gain and then claimed to set off the (E) allowable loss against his liability for capital gains tax. The claim was disallowed. The true legal effect of the two transactions treated as a whole was that the taxpayer made neither a gain nor a loss. Lord Wilberforce said of the principle of *Inland Revenue Commissioners v. Duke of Westminster*, at p. 323:

> "While obliging the court to accept documents or transactions, (F) 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 (G) 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 a combination of transactions, intended to operate as such, it is that series or combination which may be regarded."

Lord Wilberforce having considered the scheme as a whole said, at (H) p. 328:

> "On these facts it would be quite wrong, and a faulty analysis, to pick out, and stop at, the one step in the combination which

> A produced the loss, that being entirely dependant entirely upon and merely, a reflection of the gain. The true view, regarding the scheme as a whole, is to find that there was neither gain nor loss, and I so conclude."

In the present case the true view, regarding the scheme as a whole, is to find that Victory Partnership expended $3¼m.

B Lord Fraser of Tullybelton, discussing two schemes considered in *Ramsay's* case, said, at pp. 337–338:

> "The essential feature of both schemes was that, when they were completely carried out, they did not result in any actual loss to the taxpayer. The apparently magic result of creating a tax loss that would not be a real loss was to be brought about by arranging that C the scheme included a loss which was allowable for tax purposes and a matching gain which was not chargeable. In *Ramsay* the loss arose on the disposal of the appellant's shares . . . In *Rawling* it arose on the disposal of the appellant's reversionary interest in the . . . settlement. But it is perfectly clear that neither of these disposals would have taken place except as part of the scheme, and, when they did take place, the taxpayer and all others concerned in D the scheme knew and intended that they would be followed by other pre-arranged steps which cancelled out their effect. . . . There is, therefore, no reasons why the court should stop short at one particular step. . . . The absence of contractual obligation does not in my opinion make any material difference."

E The scheme in the present case had the apparently magic result of creating for tax purposes an expenditure of $14m. while incurring a real expenditure of only $3¼m.

In *Inland Revenue Commissioners v. Burmah Oil Co. Ltd.* (1981) 54 T.C. 200 dealing with another tax avoidance scheme Lord Fraser of Tullybelton said, at p. 221:

> F "The result was that although Burmah apparently suffered the loss of almost the whole price that it had paid . . . it suffered no real loss because it got back all the money . . . If the argument for Burmah is right, this would be one more case in which the taxpayer had achieved the apparently magical result of creating a tax loss that was not a real loss. In my opinion they have not achieved that result because, in the same way as in *Ramsay's* case, when the G scheme was carried through to completion there was here no real loss and no loss in the sense contemplated by the legislation."

The result in the present case, if the appellant's argument is right, is that although Victory Partnership incurred no expenditure in excess of $3¼m. it achieved the apparently magic result of creating a further tax expenditure of $10¾m. that was not a real expenditure.

H In the *Burmah* case Lord Diplock said, at p. 214:

> "It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax avoidance schemes to assume, that *Ramsay's* case did not mark a significant change in the approach

adopted by this House in its judicial role to a pre-ordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable." A

Also in the *Burmah* case Lord Scarman said, at p. 222: B

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

It is crucial, when considering the tax avoidance scheme in the present case to take the analysis far enough to determine where the expenditure on the film is really to be found. The expenditure of $10¾m. is really to be found to have been incurred by L.P.I.

In *Furniss v. Dawson* [1984] A.C. 474 the taxpayers were desirous of selling their shares to a purchaser but in order to avoid capital gains tax exchanged them for shares in a company incorporated in the Isle of Man, a transaction to which capital gains tax did not attach, and then procured the Isle of Man company to sell the original shares to the purchaser. The House held that capital gains tax was chargeable on the shares. Lord Fraser of Tullybelton said, at p. 512: D E

"The importance of this case is, in my opinion, in enabling your Lordships' House to explain the effect of the decision in *W.T. Ramsay Ltd. v. Inland Revenue Commissioners* [1982] A.C. 300 and to dispose of what are, I think, the misunderstandings about the scope of that decision which have prevailed in the Court of Appeal. In *Ramsay* the House had to consider an elaborate and entirely artificial scheme for avoiding liability to tax. Viewed as a whole, it was self-cancelling. In the present case the scheme was much simpler, and it was not self-cancelling; on the contrary, it had what Vinelott J. described as 'enduring legal consequences.' But while the cases differ in that respect, it is not a sufficient ground for distinguishing the present case from *Ramsay*. The true principle of the decision in *Ramsay* was that the fiscal consequences of a pre-ordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole, and not by dissecting the scheme and considering each individual transaction separately." F G

Lord Roskill said, at p. 515: "the ghost of the Duke of Westminster . . . has haunted the administration of this branch of the law for too long." H

In *Craven v. White (Stephen)* [1989] A.C. 398, 479, my noble and learned friend, Lord Keith of Kinkel discussing the principle which

A emerges from the *Ramsay* and *Burmah* cases and *Furniss v. Dawson* said:

> "in my opinion the nature of the principle to be derived from the three cases is this: the court must first construe the relevant enactment in order to ascertain its meaning; it must then analyse the series of transactions in question, regarded as a whole, so as to
> B ascertain its true effect in law; and finally it must apply the enactment as construed to the true effect of the series of transactions and so decide whether or not the enactment was intended to cover it. The most important feature of the principle is that the series of transactions is to be regarded as a whole."

Applying the test laid down by Lord Keith to section 41 of the Act
C of 1971 and to the single composite transaction regarded as a whole, the true effect in law was an expenditure by Victory Partnership of $3¼m., and the true fiscal effect was a first year allowance equal to that sum.

The particular form of tax avoidance scheme with which the *Lupton* [1972] A.C. 634, *Ramsay* [1982] A.C. 300 and *Burmah*, 54 T.C. 200, cases were concerned and with which this case is concerned consists of a scheme which seeks to obtain for a taxpayer a reduction in his taxable
D income without suffering any financial loss or expenditure. In *Commissioner of Inland Revenue v. Challenge Corporation Ltd.* [1987] A.C. 155, 167–168, delivering the advice of the majority, I drew a distinction between tax mitigation and tax avoidance in these terms:

> "Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable
> E income or entitle him to reduction in his tax liability. . . . Income tax is avoided . . . when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction."

The appellant claims that Victory Partnership generated a first year allowance of $14m. without incurring the expenditure of $14m. This is
F tax avoidance and falls within the principles of *Ramsay* and subsequent decisions of this House.

Attacks on the principles have been mounted. In the *Ramsay* case [1982] A.C. 300, Lord Wilberforce rejected the argument that the judges were legislating beyond their sphere. After discussing the argument, at pp. 300, 325, he said, at p. 326:

> G "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
> H 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 courts to arrive at a conclusion which corresponds with the parties' own intentions."

Another argument is that the principles of *Ramsay* and subsequent A
authorities may result in unfair and unexpected burdens on a taxpayer who is not employing a tax avoidance scheme but will not know whether the transaction he is contemplating will fall foul of these principles. So far, at any rate, a tax avoidance scheme has been recognisable by "the apparently magical result" pointed out by Lord Fraser of Tullybelton in the *Ramsay* case [1982] A.C. 300, 337, and the *Burmah* case, 54 T.C. B
200, 221. In *Lupton's* case, *Ramsay's* case, and the *Burmah* case the scheme created an apparent tax loss which was not a real loss. In *Chinn v. Hochstrasser* [1981] A.C. 533 the scheme vested trust property in a beneficiary without apparently imposing a liability to capital gains tax. In *Furniss v. Dawson* [1984] A.C. 474 the taxpayer disposed of shares without apparently creating a liability to capital gains tax. In the present case Victory Partnership created an apparent tax expenditure of C
$10¾m. which was not a real expenditure.

There is nothing magical about tax mitigation whereby a taxpayer suffers a loss or incurs expenditure in fact as well as in appearance. A taxpayer who carries out a "bed and breakfast" transaction by selling and repurchasing shares establishes a loss for capital gains tax because he has actually suffered that loss at the date of the transaction. In "back to back" transactions the taxpayer is entitled to any reduction in D
tax which Parliament has attached to each transaction. In the present case if L.P.I. had been a British company, the fact that L.P.I. borrowed $10¾m. from Chemical Bank to enable L.P.I. to make the film would not have denied to L.P.I. a first year allowance equal to the sums borrowed and expended. But Victory Partnership neither borrowed nor spent $10¾m. No difficulties have arisen and it may be that no E
difficulties will arise in applying the principles of *Ramsay* and subsequent cases to a single composite transaction provided always that these principles are understood and provided also that the results of the transaction read as a whole are correctly identified. The possibility that difficulties might arise does not provide a reason for discarding the principles which have been established by a substantial number of our eminent predecessors in this House. F

There has been a difficulty in defining and identifying a single composite transaction distinct from two or more transactions which are independent. In *Craven v. White (Stephen)* [1989] A.C. 398 this difficulty led to a difference of judicial opinion. But the difficulty does not arise in the present case and cannot affect the principles of *Ramsay* [1982] A.C. 300 and subsequent cases once a single composite transaction G
is either admitted or proved. In the present case the argument for the appellant amounts to no more than a repetition of the dictum of Lord Tomlin in the *Westminster* case [1936] A.C. 1, 30. Subsequent events have shown that though this dictum is accurate so far as tax mitigation is concerned it does not apply to tax avoidance.

The principles of *Ramsay* and subsequent cases do not compel or H
authorise the court to disregard all the fiscal consequences of a single composite transaction read as a whole on the grounds that it appears that the transaction is a tax avoidance scheme. In the present case the commissioners felt bound to ignore all the fiscal consequences which are

A beneficial to the taxpayer because Victory Partnership had entered into the scheme "with fiscal motives as the paramount object."

Similarly, in the view of the Sir Nicolas Browne-Wilkinson V.-C., the taxpayer is deprived of all the beneficial effects of the scheme if the scheme was entered into "essentially for the purpose of obtaining a fiscal advantage under the guise of a commercial transaction:" [1991] 1 W.L.R. 341, 357.

B In the view of the Vice-Chancellor, expressed at p. 355:

> "if the commissioners find as a fact that the *sole* object of the transaction was fiscal advantage, that finding can in law only lead to one conclusion, viz. that it was not a trading transaction. . . . if the commissioners find as a fact only that the paramount intention was fiscal advantage . . . the commissioners have to weigh the
> C paramount fiscal intention against the non-fiscal elements and decide as a question of fact whether in essence the transaction constitutes trading for commercial purposes."

My Lords, I do not consider that the commissioners or the courts are competent or obliged to decide whether there was a sole object or paramount intention nor to weigh fiscal intentions against non-fiscal
D elements. The task of the commissioners is to find the facts and to apply the law, subject to correction by the courts if they misapply the law. The facts are undisputed and the law is clear. Victory Partnership expended capital of $3¼m. for the purpose of producing and exploiting a commercial film. The production and exploitation of a film is a trading activity. The expenditure of capital for the purpose of producing and
E exploiting a commercial film is a trading purpose. By section 41 of the Act of 1971 capital expenditure for a trading purpose generates a first year allowance. The section is not concerned with the purpose of the transaction but with the purpose of the expenditure. It is true that Victory Partnership only engaged in the film trade for the fiscal purpose of obtaining a first year allowance but that does not alter the purpose of the expenditure. The principles of *Ramsay* and subsequent authorities
F do not apply to the expenditure of $3¼m. because that was real and not magical expenditure by Victory Partnership.

The Vice-Chancellor referred to authorities in which intentions sometimes illuminated and sometimes obscured the identification of a trading purpose. But in every case actions speak louder than words and the law must be applied to the facts.

G In *Religious Tract and Book Society of Scotland v. Forbes* (1896) 3 T.C. 415 a society founded for the diffusion of religious literature sent out agents who travelled from door to door with the object of engaging a customer in religious discussions so as to spread the gospel while selling the Bible and religious tracts. The sales by the agents were carried on at a loss. It was held that an agent was a missionary and not a trader.

H In *Iswera v. Commissioner of Inland Revenue* [1965] 1 W.L.R. 663 the taxpayer wished to live near the school attended by her daughter and for that purpose was obliged to buy a site of two acres. She divided the site into 12 lots and sold the lots except for two lots upon which she

built her house. She was held to have traded. Lord Reid said, at A
p. 668:

> "If, in order to get what he wants, the taxpayer has to embark on
> an adventure which has all the characteristics of trading, his purpose
> or object alone cannot prevail over what he in fact does. But if his
> acts are equivocal his purpose or object may be a very material
> factor when weighing the total effect of all the circumstances." B

The taxpayer contended that her intention and purpose in expending
capital on the two acres was to enable her to live near her daughter's
school. Nevertheless on the facts she traded.

Difficulties do arise in determining whether an asset has been
acquired and dealt with as a capital asset of a business or as trading
stock or is not an asset of the business at all. In these cases, findings of C
fact by the commissioners may be decisive. A purchaser of a diamond
mine acquires a capital asset; a jeweller acquires diamonds as trading
stock; diamonds are a girl's best friend but they do not constitute her
trading stock. These difficulties do not arise in the present case;
Victory Partnership expended capital for a trading purpose namely the
production and exploitation of a film. D

In *Simmons (as liquidators of Lionel Simmons Properties Ltd.) v.
Inland Revenue Commissioners* [1980] 1 W.L.R. 1196 properties acquired
by a group for retention and thus for capital purposes were sold on the
liquidation of the group. The commissioners held that the decision to
liquidate was not inconsistent with the original aim to create investments
for retention where possible, or where not possible for turning to
account by way of trade. Their profits from the sales were not trading E
profits. Lord Wilberforce said, at p. 1199:

> "One must ask, first, what the commissioners were required or
> entitled to find. Trading requires an intention to trade; normally
> the question to be asked is whether this intention existed at the
> time of the acquisition of the asset. Was it acquired with the
> intention of disposing of it at a profit, or was it acquired as a F
> permanent investment? Often it is necessary to ask further
> questions: a permanent investment may be sold in order to acquire
> another investment thought to be more satisfactory; that does not
> involve an operation of trade, whether the first investment is sold at
> a profit or at a loss. Intentions may be changed. What was first an
> investment may be put into the trading stock—and, I suppose, vice- G
> versa. If findings of this kind are to be made precision is required,
> since a shift of an asset from one category to another will involve
> changes in the company's accounts, and possibly, a liability to tax:
> see *Sharkey v. Wernher* [1956] A.C. 58. What I think is not
> possible is for an asset to be both trading stock and permanent
> investment at the same time, nor to possess an indeterminate
> status—neither trading stock nor permanent asset. It must be one H
> or other, even though, and this seems to me legitimate and
> intelligible, the company, in whatever character it acquires the
> asset, may reserve an intention to change its character."

A This case illustrates a difficulty which does not arise in the present case and does not give rise to any question of fact determinable by the commissioners. The only facts are the 17 documents and the activities which were carried out pursuant to those documents.

In *Coates v. Arndale Properties Ltd.* [1984] 1 W.L.R. 1328 a group of companies included a property developing company, a property dealing company and an investment company. The property development B company spent £5·2m. in developing leasehold property but at the end of the day the lease was only worth £3m. so that the property development company and the group were faced with a capital loss of £2·2m. The group secured the assignment of the lease from the property development company to the property dealing company at market value and then the assignment by the property dealing company C to the investment company at market value plus £10m. The property dealing company claimed that it had acquired the lease as trading stock and was entitled under section 274 (1) of the Income and Corporation Taxes Act 1970 and Schedule 7, paragraph 1(3) to the Finance Act 1965 claim a trading loss of £2·2m. deductible from group profits. This House held that the property dealing company did not acquire the lease as trading stock. The assignments of the lease had no commercial D justification and only transferred a capital asset from the first member of the group to the third member of the group via the second member of the group in order to convert group capital into income temporarily; on a true analysis the taxpayer did not trade at all.

In *Reed v. Nova Securities Ltd.* [1985] 1 W.L.R. 193 the taxpayer claimed to have acquired certain shares and book debts as trading stock E and to have made deductible losses for corporation tax purposes. The taxpayer was a trading company and there was some commercial justification for the acquisition of the book debts at the price paid by the company. The commissioners held that the company had acquired the book debts as trading stock. This House refused to interfere with that finding. The shares were however worthless and there was no commercial justification for their purchase. The shares were therefore not trading F stock and the decision of the commissioners was reversed. There was a tax avoidance motive in both transactions. This did not prevent the taxpayer from claiming and proving that the book debts had been acquired and disposed of as trading stock.

In *Overseas Containers (Finance) Ltd. v. Stoker* [1989] 1 W.L.R. 606 a parent company, anticipating losses on capital account in respect of G loans repayable in German currency formed the taxpayer company as a finance company which took over the loans, sustained the losses and claimed to deduct the loans for the purposes of corporation tax. The commissioners, Vinelott J. [1987] 1 W.L.R. 1521 and the Court of Appeal [1989] 1 W.L.R. 606 held that the acquisition of the loans by the financing company was not a trading transaction. Vinelott J. said [1987] 1 W.L.R. 1521, 1530:

H
> "The only purpose of the interposition of the taxpayer company was to transmute the base metal of an exchange loss on capital account into the pure gold of a revenue loss. A transaction designed to achieve that fiscal alchemy is not a trading transaction."

In the present case the legal effect of the transaction, whatever its A
design was a trading transaction whereby Victory Partnership expended
$3¼m. towards the production of a film in which Victory Partnership had
a 25 per cent. interest.

All these authorities were dealing with the identification of a trading
transaction. In the present case a trading transaction can plainly be
identified. Victory Partnership expended capital in the making and
exploitation of a film. That was a trading transaction which was not a B
sham and could have resulted in either a profit or a loss. The
expenditure of $3¼m. was a real expenditure. The receipts of $3m. were
real receipts. The expenditure was for the purpose of making and
exploiting a film and entitled Victory Partnership to a first year allowance
equal to the expenditure. The receipts imposed on Victory Partnership
a corporation tax liability. C

I would set aside the orders of the Court of Appeal and Millett J.
and refer the case back to the commissioners to determine in default of
agreement the tax assessment of the appellant on the footing that
Victory Partnership generated a first year allowance of $3¼m. in
connection with the film "Escape to Victory."

I come finally to the question of costs. The tax avoidance scheme
introduced by Guinness Mahon to the appellant presented the appellant D
(in words adopted from those of Lord Donovan in *Lupton v. F.A. &
A.B. Ltd.* [1972] A.C. 634, 657) with an opportunity to claim from the
revenue the benefit of a large sum which the appellant had never
disbursed. Though section 41 of the Act of 1971 required a taxpayer to
expend $14m. in order to qualify for a first year allowance of that
amount, the scheme was embraced because it was thought to obtain that E
allowance for an expenditure of only $3¼m. The scheme, again in the
words of Lord Donovan was the planning and execution of a raid on
the Treasury using the technicalities of revenue law and company law as
the necessary weapons. Mr. Gardiner said that the appeal had been
successful in that the appellant had established a first year allowance of
$3¼m. But the appellant denied the existence of a first year allowance
limited to $3¼m. The raid has failed and the appellant must pay the F
costs in this House and in the courts below.

LORD GOFF OF CHIEVELEY. My Lords, the question in the present
case is whether the appellant company, Ensign Tankers (Leasing) Ltd.,
and the four other British limited partners in Victory Partnership
("V.P."), are entitled under section 41(1) of the Finance Act 1971 to the G
benefit of any capital allowance in respect of sums expended by V.P. on
the making of the film "Escape to Victory" and, if so, to what allowance
they are so entitled.

The facts are set out in the speech of my noble and learned friend,
Lord Templeman, whose account of the transaction in question, and in
particular of the numerous, interlocking, documents executed on 14 July
1980, I gratefully adopt. It is obvious that the transaction is what is H
usually called a tax avoidance scheme. In common sense terms, the film
was made by Lorimar Productions Inc., and V.P. contributed $3¼m. to
the cost of making the film, receiving in return a 25 per cent. equity

participation. If that is the true position, V.P. is entitled to a capital allowance in respect of that expenditure. But the function of the various documents signed on 14 July 1980 is to present a different picture, under which L.P.I. made the film of behalf of V.P., which incurred the total cost of $14m., the balance over and above $3¼m. being lent by L.P.I. to V.P. to enable V.P. to finance the remainder of the film. On this basis, it has been the contention of V.P. that, since it spent $14m. on the making of the film, it is entitled to a capital allowance in respect of that sum.

Like my noble and learned friend, Lord Templeman, I approach this case on the basis that there is a fundamental difference between tax mitigation and unacceptable tax avoidance. Examples of the former have been given in the speech of my noble and learned friend. These are cases in which the taxpayer takes advantage of the law to plan his affairs so as to minimise the incidence of tax. Unacceptable tax avoidance typically involves the creation of complex artificial structures by which, as though by the wave of a magic wand, the taxpayer conjures out of the air a loss, or a gain, or expenditure, or whatever it may be, which otherwise would never have existed. These structures are designed to achieve an adventitious tax benefit for the taxpayer, and in truth are no more than raids on the public funds at the expense of the general body of taxpayers, and as such are unacceptable. Again, examples have been given in the speech of my noble and learned friend. The question in the present case is into which of these two categories the transaction under consideration falls.

Now, if one takes certain individual features of the transaction, and considers them in isolation, it is possible to give some colour to V.P.'s argument. For example, it is no doubt correct that the mere fact that the taxpayer borrows money in order to incur capital expenditure does not prevent him from qualifying for a capital allowance under the section; likewise the mere fact that such a loan is a non-recourse loan in the sense that the taxpayer is not personally liable for its repayment, the loan being repayble out of property or proceeds in the hands of the taxpayer, will not of itself prevent the transaction from constituting what is in in truth a loan, or the expenditure so financed qualifying for a capital allowance. But it is well established in the cases that we should not, for present purposes, have regard to such features in isolation. Indeed the authorities require us to look at related transactions such as those which were entered into on 14 July 1980 as one composite transaction. It is that composite transaction which we have to analyse, as a whole, in order to ascertain its true nature and effect, and to decide whether the transaction so analysed results, on a true construction of the relevant statutory provision, in the taxation consequences for which the taxpayer contends.

I turn therefore to the composite transaction. Under it, the title to the negative of the film was transferred to or vested in V.P., and it was provided that the film should be made by L.P.I. for V.P. But, as part of the same transaction, the exclusive right to distribute and exploit the film was vested in two companies (the distributors) which were wholly owned subsidiaries of L.P.I.; and the distributors were directed, after

retaining their fees and expenses, to distribute the net profits from the A
film in proportions which resulted in V.P. receiving a share of 25 per
cent. and no more. Next, under the composite transaction L.P.I. was to
pay sums of money to V.P.; but each sum was to be paid into a bank
account opened by V.P. at a bank nominated by L.P.I., and an exactly
equivalent sum was on the same day to be paid out of the same account
to L.P.I., so that at the close of the day's trading the account was never
in debit or in credit. In the documents, the sums so paid by L.P.I. to B
the credit of V.P. were characterised as loans of money advanced by
L.P.I. to enable V.P. to finance the balance of the approved budget for
the film (the production loan) and any further sum required to complete
the film (the completion loan); the sums recredited to L.P.I. were
characterised as payments made by V.P. to finance the making of the
film; and the distribution to L.P.I. of a 75 per cent. share of the net C
profits from the film was characterised as repayment of the money lent
by L.P.I. to V.P. But the so-called loan by L.P.I. to V.P., and the so-
called payments by V.P. to finance the making of the film, were self-
cancelling transactions; and the distribution of net profits to L.P.I. was
consistent with an investment by L.P.I. in the film equal to the balance
of the cost of the film over and above the $3¼m. invested by V.P.

I am prepared (with some hesitation) to accept that the composite D
transaction which I have just described should not be called a sham, in
the narrow sense in which that word has been used in this context. I
accept, for example, that title to the negative did indeed vest in V.P.;
though the distribution arrangements which formed part of the same
composite transaction deprived that legal ownership of any meaningful
effect. I accept, too, that money was indeed paid by L.P.I. to V.P. on E
the various occasions when the relevant account was credited; although
that too was deprived of any practical effect by the immediate repayment,
on the same day, of exactly the same sum from that account. What I
have to do, however, is to stand back from the composite transaction; to
look at it as a whole; and to decide, first, what is the true nature and
effect of the transaction and, second, whether, on a true construction of
section 41(1) of the Finance Act 1971, V.P. is entitled to an allowance F
in respect of the whole of the cost of the film, viz. $14m.

When I embark upon this process, I find it impossible to characterise
the money paid by L.P.I. into the bank account to the credit of V.P. as,
in any meaningful sense, a loan. It was not in my opinion money lent
to V.P. to enable V.P. to finance the production of the film. It was
money paid by L.P.I. into the bank account opened in V.P.'s name to G
enable V.P. to indulge in a tax avoidance scheme, and for no other
purpose. I derive this conclusion from a number of provisions in the
composite transaction, viz.:

(1) L.P.I. continued to make the film as before, with all matters
relating to the film (including cost) remaining under its control, and
bearing the burden of any financial over-run beyond the approved
budget of $13m. H

(2) The bank account into which money was to be paid by L.P.I.
was to be opened at a bank nominated by L.P.I., and no money was to
be drawn from the account without the consent of L.P.I.

(3) When money was paid into the bank account by L.P.I., an identical sum was repayable by V.P. to L.P.I. out of the same bank account on the same day, leaving no balance outstanding at the end of the day's trading.

(4) By a non-recourse agreement, neither V.P. nor any partner in V.P. was personally liable for the repayment of the so-called loan.

(5) The so-called loan was repayable to L.P.I. by payments out of the net profits of the film under arrangements which were inconsistent with the concept of a commercial loan. For example (a) repayment to L.P.I. of the production loan ranked equally with the recoupment of V.P.'s investment of $3¼m.; (b) V.P.'s investment of $3¼m. was to be recovered before repayment of L.P.I.'s completion loan; (c) although provision was made for payment of interest to L.P.I., payment of interest was postponed until after V.P. had recovered its investment of $3¼m. (with the effect that, in the present case, no interest was in fact recovered by L.P.I.); and (d) after repayment of the production and completion loans with interest, and recovery by V.P. of its investment of $3¼m., the balance (if any) of the net profits was to be distributed as to 75 per cent. to subsidiaries of L.P.I. and as to 25 per cent. to V.P. Had the so-called production and completion loans been ordinary commercial loans by L.P.I. to V.P. to enable it to finance the production of the film, the loans and interest would have been repayable before V.P. recovered any part of its investment, and provision would have been made for V.P. to recoup the whole of its investment (including that financed by borrowing from L.P.I.) from the balance of the net profits from the film.

In the circumstances it is, I consider, a misuse of language to describe the payments made by L.P.I. into the bank account as a loan by L.P.I. to V.P. to enable V.P. to finance the making of the film by L.P.I. on its behalf, in excess of V.P.'s investment of $3¼m. As I have already said, it was simply money paid by L.P.I. into the account as the first step in a tax avoidance scheme; in my opinion, it cannot sensibly be characterised in any other way. It follows that the money paid back to L.P.I. out of the bank account cannot be regarded, on a true construction of the statute, as expenditure incurred by V.P. in the making of the film. The sole function of these payments of identical sums to those which had been paid into the account on the same day was to achieve the second stage in the tax avoidance scheme. In my opinion, such payments cannot properly be regarded as capital expenditure incurred by V.P. in the making of the film within section 41(1) of the Act of 1971. In truth, the real finance for the approved budget for the film came as to 25 per cent. from V.P., and as to 75 per cent. from L.P.I. (from money advanced to it by its bankers, Chemical Bank).

In short, this is indeed a case in which, as though by magic, the appearance is given that the taxpayer has incurred capital expenditure, but the truth is otherwise. The structure created to achieve the conjuring trick is, as usual in such cases, both complex and artificial. Here the trick consists of, first, the pre-arranged self-cancelling transactions under which L.P.I. purported to advance money to V.P., and V.P. immediately repaid identical sums, on the same day; and

second, the characterisation of part of L.P.I.'s share of the net profits A
from the film as repayment of the so-called loans by L.P.I. to V.P. The
self-cancelling payments by L.P.I. to V.P. and repayments by V.P. to
L.P.I. are typical examples of artificial transactions, the sole purpose of
which is the avoidance of tax. They can, in my opinion, be properly
disregarded for the purposes of tax. The transfer or vesting of the title
to the negative of the film, too, has no function other than to give
colour to the tax avoidance scheme, since the net profits from the film B
were in any event to be shared in accordance with the parties' respective
contributions; it can therefore be treated as irrelevant for present
purposes. Finally, the distribution of net profits to L.P.I. can be treated
for what it in truth was, the arrangement being wholly inconsistent with
the repayment of a commercial loan.

From the foregoing analysis, I conclude that V.P. was trading, though C
only to the extent of its investment of $3¼m. and no more; and that that
sum constituted, on a true construction of the statute, the only capital
expenditure incurred by V.P. in the making of the film. This conclusion
leads to the sensible and realistic consequence that V.P. is not deprived of
a capital allowance in respect of that sum, which would have been the case
if V.P. had been held not to have been trading at all.

For these reasons, and for the reasons given by my noble and D
learned friend, Lord Templeman, I concur in the order proposed by
him.

LORD JAUNCEY OF TULLICHETTLE. My Lords, there is one matter
upon which I should like to add a few words to those in the speech of
my noble and learned friend, Lord Templeman. As he has pointed out E
the expenditure by Victory Productions of $3¼m. on the making of the
film in return for 25 per cent. of the net receipts carried all the
characteristics of trade. The question which has exercised me is whether
having regard to the decision in this House in *Lupton v. F.A. & A.B.
Ltd.* [1972] A.C. 634, the above trading characteristics have been so
eclipsed by the non-trading measures designed to obtain a capital
allowance in respect of sums of money far in excess of what had been F
truly expended by the tax payer that they can only be treated as part of
an overall non-trading transaction.

Lupton v. F.A. & A.B. Ltd. was a dividend-stripping case in which
the purchasers of shares pregnant with profits sought to create a loss for
the purposes of section 341 of the Income Tax Act 1952 by declaring a
large dividend which had the effect of devaluing the shares by the G
amount of the dividend declared. The taxpayer did not seek to make a
profit by the transaction, indeed at the conclusion of the transaction he
was financially in broadly the same position as he was when he entered
into it. The profit was to arise from a successful claim under section 341
that a loss had been sustained by the devaluation of the shares as a
result of the declaration of the dividend.

Lord Morris of Borth-y-Gest said, at p. 647: H

> "It is manifest that some transactions may be so affected or inspired
> by fiscal considerations that the shape and character of the
> transaction is no longer that of a trading transaction."

A And, at p. 648, he quoted with approval the following remarks of Megarry J. [1968] 1 W.L.R. 1401, 1419 at first instance:

> "On the other hand, if the greater part of the transaction is explicable only on fiscal grounds, the mere presence of elements of trading will not suffice to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an
> B artificial structure, remote from trading and fashioned so as to secure a tax advantage, the mere presence in that structure of certain elements which by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure."

Viscount Dilhorne said [1972] A.C. 634, 657:

> "My Lords, if a transaction viewed as a whole is one entered into
> C and carried out for the purpose of establishing a claim against the revenue under section 341, I for my part would have no hesitation in holding that it does not form part of the trading activities of a dealer in stocks and shares."

My Lords, at first sight I was inclined to the view that these observations were in point in the present case where there is no doubt that by far the greater number of steps in the transaction were directed
D to obtaining a capital allowance in relation to a sum in excess of the $3¼m. truly expended by the taxpayer. However on further consideration I am satisfied that there are no dicta in *Lupton v. F.A. & A.B. Ltd.* which force me to conclude that the investment of $3¼m. by Victory Productions was not expenditure for the purposes of trade. *Lupton v. F.A. & A.B. Ltd.* was an all or nothing case in which the only question
E was whether or not the relevant transactions formed part of the trading activities of a dealer in stocks and shares. This House did not in *Lupton v. F.A. & A.B. Ltd.*, require to address itself to a situation where what would otherwise be a trading transaction producing financial and fiscal consequences formed part of a tax avoidance scheme. I do not consider that *Lupton v. F.A. & A.B. Ltd.* requires that the trading transaction be denatured because the taxpayer has incorporated it within a tax
F avoidance scheme which seeks to obtain for him greater fiscal advantages than the trading transaction if standing alone would produce. When Parliament has provided that a taxpayer shall be entitled to certain allowances in certain circumstances I can see no reason in principle why when those circumstances exist he should be deprived of those allowances simply because he has sought and failed to engineer a situation in which
G he obtained allowances greater than those to which the circumstances entitled him. Where, as here, there is, as my noble and learned friend has pointed out, an end result which has both financial and fiscal consequences, the proper approach is to disregard the steps in this scheme which have no commercial purpose rather than to treat those steps as somehow affecting or denaturing other steps in the scheme having such a purpose. In support of this proposition I cannot do better
H than cite the well known passage from the speech of Lord Brightman in *Furniss v. Dawson* [1984] A.C. 474, 527:

> "The formulation by Lord Diplock in *Inland Revenue Commissioners v. Burmah Oil Co. Ltd.* [1982] S.T.C. 30, 33 expresses the

limitations of the *Ramsay* principle. First, there must be a pre-ordained 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 Dawsons 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."

My Lords, in all the circumstances I entirely agree with the reasoning of my noble and learned friend, Lord Templeman, in his speech and with the course which he therein proposes.

Appeal allowed.
Taxpayer to pay costs in House of Lords and below.

Solicitors: Belmont & Lowe for Hugh James Jones & Jenkins, Cardiff; Solicitor of Inland Revenue.

A. R.