LEGAL RESEARCH PAPER SERIES
Paper No 14/2015 **April 2015**

Lord Hoffmann, Tax Law and Principles

JUDITH FREEDMAN

in PS Davies and J Pila (eds), *The Jurisprudence of Lord Hoffmann* (Oxford: Hart Publishing, 2015)

15

Lord Hoffmann, Tax Law and Principles

Judith Freedman CBE

I. Introduction

In the realm of tax law, as in other areas discussed in this book, Lord Hoffmann's strongest theme has been one of purposive construction. Lord Hoffmann helped to review and revise an approach to tax avoidance at a time when it had moved away from purposive construction toward a judicial rule of doubtful propriety (the so-called '*Ramsay* principle').[1] At one point, however, Lord Hoffmann's explanation of his approach to construction threatened to create another type of formula—a distinction between commercial and juristic concepts, which proved to be impractical. What might have worked if always in his expert hands would not necessarily work in the hands of others. An approach that cannot be applied at all levels of the legal system is unlikely to be a sensible way forward.

There is a tendency amongst lower courts, and those on the ground who have to implement legislation, to look for concrete rules and formulaic guidance. Purposive construction alone may appear to give rise to uncertainty, especially in an area where the purpose of the legislation can be elusive. In such circumstances, references to 'economic' or 'commercial' concepts do not provide the kind of guidance that is sought. This means that, despite the serious intellectual effort and judicial focus that have been brought to bear on the problem of construing tax legislation to give effect to the intention of Parliament, the case law on tax avoidance remains unsatisfactory and resort is frequently taken to legislative 'solutions'.

Very often these legislative solutions take the form of specified tax avoidance provisions, but the apparent inability of the judiciary to solve the tax avoidance problem has led also to the introduction of a statutory general anti-abuse rule (GAAR). Lord Hoffmann participated in a study group advising on the development and adoption of a UK GAAR.[2]

---

[1] The *Ramsay* principle emerged *in WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 (HL) and was subsequently developed in a series of cases. For articles analysing the way in which the case law developed see, eg, J Freedman, 'Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle' [2004] *British Tax Review* 332; E Simpson, 'The Ramsay Principle: a Curious Incident of Judicial Reticence?' [2004] *British Tax Review* 358; J Tiley, 'Tax Avoidance Jurisprudence as Normal Law' [2004] *British Tax Review* 304; J Freedman, 'Interpreting Tax Statutes: Tax Avoidance and the Intention of Parliament' (2007) 123 *LQR* 53; M Gammie, 'Moral Taxation, Immoral Avoidance—What Role for the Law?' [2013] *British Tax Review* 577.

[2] Lord Hoffmann was a member of the Aaronson Study Group which put forward a proposal for a statutory anti-abuse provision at the request of the UK Government. See G Aaronson, 'GAAR Study: A study to consider whether a general anti-avoidance rule should be introduced into the UK tax system' (Report) (November 2011) <http://webarchive.nationalarchives.gov.uk/20130605083650/http://www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf> accessed 16 December 2014 (Aaronson Report). The author was also a member of that study group. The proposed legislation was subsequently enacted in the Finance Act 2013.

This suggests an acceptance that the judiciary cannot tackle the problem of tax avoidance resulting from abuse of tax legislation without assistance. The legislative approach in the GAAR is not, however, one that relieves judges of the need to look at the purpose of the legislation. In fact it requires them to look very carefully at the purpose of the legislation, but provides a framework to guide them in this difficult endeavour and, in certain circumstances, allows them to go beyond the confines of pure purposive construction as it is usually applied in the UK. This solution neatly frames Lord Hoffmann's views of the role of the judiciary in such cases.

II. Hunting for Tax Principles

Tax law is sometimes seen as an area devoid of principle: those who are not involved in tax law (and even more worryingly many tax practitioners and some revenue officials and draftsmen) tend to think of it only as a mass of technical detail. It is an area where clear principles are badly needed, but are not always present. The underlying tax policy is often incoherent as well as very complex, so that the application of logic does not always offer a solution. The ultimate objective should always be to raise revenue, of course, but beyond that there may be many different and frequently conflicting objectives.[3] Redistribution of wealth may be a primary objective of taxation for some and less significant for others. Taxation may be seen as a legitimate device to subsidise taxpayers with certain needs, and most 21st century policy makers will consider that tax liability should reflect ability to pay. Tax is frequently used to encourage certain forms of behaviour such as investment, saving, environmentally friendly energy use and even riding a bicycle to work. Some taxes aim to discourage certain behaviours, such as drinking alcohol, smoking or eating sugar. Tax law is also used to assist some efforts to manage the macro-economy as well as to allocate revenues between sovereign states.

Sometimes these objectives conflict: a tax which really did prevent smoking would reduce revenue substantially. Frequently, efficiency of taxation needs to be traded off against equity. This multiplicity of objectives creates complexity. Each objective needs to be balanced against an often expressed desire for simplicity in taxation. This process of trade offs is described by economists as optimal tax theory.[4] In practice, this weighing up process rarely takes place in a complete manner, if at all and, when these issues are considered, the policy makers do not start with a clean sheet of paper. Often there are too many political pressures for any serious consideration of the fundamentals. So sometimes there are no clear objectives, and even where they are clear, they may clash with other objectives within the tax system as a whole. Further, objectives that are perfectly clear in a straightforward case may be difficult to implement or target. This confusion surrounds not only the creation of new taxes but also the addition of new reliefs.

[3] There is a vast literature on this topic but for a convenient modern summary see S Adam and others (eds), *Tax by Design: The Mirrlees Review* (Oxford, Oxford University Press, 2011).
[4] ibid 35 paras 2.2.1 et seq.

Politicians treat tax law as a political football and compete with each other to introduce one relief after the other. The National Audit Office (NAO) has reported that there are more than 1,000 reliefs in the UK tax system.[5] This is not a particularly useful figure, given that it covers a range of reliefs of very different types. Some are essential to define the tax base, such as the ability to deduct losses, whilst others are specific incentives to encourage certain behaviour, such as the allowance for individual savings accounts (ISAs). The NAO report does, however, underline the range and extent of complexity introduced into the UK tax system (as in many others) by the variety of tax incentives and other reliefs available. The Public Accounts Committee (PAC) under Margaret Hodge's leadership has been particularly vociferous in criticising the proliferation of tax reliefs, having seen how many of the tax schemes that the PAC considers unacceptable have been based on such reliefs.[6] Even though a relief may appear to have a clear economic objective, as soon as the policy descends into practicalities, questions may arise which start to muddy the waters, and the reliefs start to be used for purposes not initially envisaged by the policy makers.

There is often pressure on civil servants and other policy advisers from Ministers to find 'quick wins' and tax changes that will appeal to the electorate at the annual budget. This annual budget event generates a proliferation of unnecessary and often unprincipled changes, as politicians feel the need to be seen to be acting and advisers are required to provide them with ideas for this purpose. The Office of Tax Simplification, set up to review the tax system with simplification in mind, also seems all too often to be under pressure to come up with ideas that can be implemented quickly and will therefore inevitably be piecemeal.[7]

Even tax incentives that seem to have a good policy rationale are often poorly targeted. So, for example, loss making businesses that need financial help may not be able to utilise tax incentives for investment because they have no taxable profits, so they may enter into an arrangement with a bank whereby the bank takes the tax benefit and shares it with the taxpayer in some form. The finance leasing industry was built on the use of tax incentives for investment in plant and machinery (capital allowances) in this way, with the bank purchasing the asset and claiming the allowance. The asset is then leased on to the business. Some of the tax benefit is enjoyed by the bank, but this may mean that the bank will provide finance on better terms than it otherwise would do, which may said to be within the original policy. It is just one more step from this for a bank to take the benefit of the relief in other circumstances

[5] National Audit Office, 'Tax Reliefs' HC (2013–14) 1256.

[6] Report from the Committee of Public Accounts, 'Tax reliefs' HC (2014–15) C 282 (incorporating HC (2013–14) 1155).

[7] For details of the Office of Tax Simplification (OTS) see <http://www.gov.uk/government/organisations/office-of-tax-simplification> accessed 16 December 2014. As an example to illustrate the point in the text, the terms of reference for the OTS employment status review issued on 11 July 2014 refer expressly to 'quick wins' for the Budget 2015, despite acknowledging that the report could recommend more significant reforms that would need to be left until after the 2015 General Election (see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/336881/Letter_from_OTS_to_XST_re_employment_status_and_tax_penalties_TORs.pdf accessed 16 December 2014). This seems to be an area where piecemeal reforms have already caused a great deal of trouble and where a holistic view is needed, especially as it needs to consider the relationship between tax and employment law.

where it is not available to the taxpayer because the taxpayer does not satisfy some other condition. At what point the sharing by the banks of the advantages of the incentive tips over from being within the 'intention' of the legislation to being outside it is a difficult question. Does it depend on how much of the benefit the bank keeps for itself and how much it shares with the business? Can the arrangement extend to a sale and leaseback? The question that may arise for the courts in a tax avoidance scheme will be at what point the 'normal and accepted trade of finance leasing'[8] becomes something outside the purpose of the tax incentive giving legislation. Experience has shown that this is an extremely difficult line to draw and not one where looking at the underlying principles and the purpose of the legislation gives every reasonable person the same answer.

The response to this difficulty in targeting incentives has been to add anti-avoidance provisions when introducing the legislation, with further provisions as and when an adviser finds a way around the original provisions. This creates the perfect conditions for 'creative compliance', as Doreen McBarnet has called it.[9] That is, the legislation can be carefully followed but used in a way that transactions can be argued to be 'legal' and effective, despite the fact that some, even most, observers would believe they undermine the purpose of that legislation. One of the best ways to create a good scheme for reducing tax is to take the carefully crafted and therefore watertight anti-avoidance legislation and stand it on its head by using it for a different purpose from that envisaged.[10] Nevertheless, policy makers continue to encrust new provisions with anti-avoidance provisions, based on the knowledge that new reliefs often result in new tax avoidance methods.

The creation of poorly targeted tax incentives can create honest confusion about the way in which incentives that have been deliberately granted can be used and the limits on that use. Further, anti-avoidance provisions may create problems for those engaged in complex transactions entered into for genuine commercial purposes. These transactions may become complicated, even convoluted, because the underlying tax law is not fit for purpose and fails to prevent double taxation or fails to provide for the circumstances that have arisen. e. At

[8] See *Barclays Mercantile Business Finance Ltd v Mawson (Inspector of Taxes)* 76 TC 446 (HC, CA and HL) (*BMBF*) [52] (Carnwath LJ): '[T]he tax advantage, which is said to have infected the whole scheme, is one which is a normal and accepted part of BMBF's finance leasing trade. As the Judge [in the High Court, Park J as he was then] recognised, in this trade: "[T]he obtaining of capital allowances for the leasing company's expenditure on acquiring the machinery or plant is fundamental. The lease rates are set at levels which assume that the lessor (or companies grouped with it) will benefit from the allowances. If the allowances are not obtained after all, the transaction ceases to make financial and commercial sense."'

[9] D McBarnet and C Whelan, 'The Elusive Sprit of the Law: Formalism and the Struggle for Legal Control' (1991) 54 *MLR* 848.

[10] See, eg, Taxation of the Chargeable Gains Act 1992 (TCGA) s 17, interpreted in *Harrison v Nairn Williamson Ltd* 51 TC 135 (HC, CA) as applying when there is an acquisition of an asset with no disposal. Although this was a win for the Revenue on the facts of that case, following this decision the market value rule was frequently manipulated to the taxpayer's advantage. Section 17(2) TCGA was then introduced to restrict the operation of the market value rule. (See HMRC, 'CG14550—Market value rule: acquisition no disposal: disposal no acquisition' (Capital Gains Tax Manual) TCGA92/S17 <http://www.hmrc.gov.uk/manuals/cgmanual/cg14550.htm> accessed 16 December 2014.)

other times a complex structure is needed for regulatory or other reasons. The interaction of the anti-avoidance provisions with other circumstances can create confusion.

The result of this process of legislating, and then adding wide anti-avoidance provisions, is that tax advisers complain of uncertainty and the traps for the unwary that arise when a system is complex. Recent years have seen an increase in consultation, which has been welcomed by many practitioners and can remove some difficulties, but consultation can also create further complexity, and ultimately greater uncertainty, despite the declared aim being the opposite effect.[11] The reaction of practitioners consulted on draft legislation is generally to suggest adding detail to cover this or that point in the hope that this gives them precision. This runs counter to all experience—our tax legislation is close to being the longest in the world and we still need many pages of extra-statutory guidance of dubious status.[12] This hardly suggests that detail will solve the problem of lack of certainty, but the practitioners seem convinced that this is the correct way to proceed. Parliamentary draftsmen naturally respond to this message by adopting a detailed rather than a principles based approach to drafting.[13] Thus, it is much easier to talk about having a tax system based on clear principles than to implement that idea.

III. Lord Hoffmann's Views on Statutory Construction, Principles and Policy

The lack of principle and difficulty in targeting legislation described in the previous section of this chapter makes tax an unwieldy area for any judge, but in particular for one who, like Lord Hoffmann, believes in the primacy of construction and the search for principle in answering the question of how to interpret the legislation.[14] Whilst this approach clearly goes beyond pure literal interpretation, this does not mean that using this method open the way for the judge to impose his own views on what the outcome should be. This remains a matter of statutory construction. In Lord Hoffmann's memorable phrase in the *Norglen* case:

> If [tax avoidance schemes] do not work, the reason, as my noble and learned friend Lord Steyn pointed out in *IRC v McGuckian,* [1997] 1 WLR 991, 1000, is simply that upon the true construction of the statute, the transaction which was designed to avoid the charge to tax actually comes within it. It is not that the statute has a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit

[11] HMRC, *The New Approach to Tax Policy Making* (December 2010) <http://webarchive.nationalarchives.gov.uk/20130129110402/http:/www.hm-treasury.gov.uk/d/tax_policy_making_response.pdf.pdf> accessed 16 December 2014.

[12] As to the status of extra-statutory guidance in tax law see J Freedman and J Vella, 'HMRC's Management of the U.K. Tax System: The Boundaries of Legitimate Discretion' in J Freedman, C Evans and R Krever (eds), *The Delicate Balance: Revenue Authority Discretions and the Rule of Law* (Amsterdam, IBFD, 2011).

[13] J Freedman, 'Improving (Not Perfecting) Tax Legislation: Rules and Principles Revisited' [2010] *British Tax Review* 717.

[14] This approach is explained in Lord Hoffmann's review of S Lee, *Judging Judges* (London, Faber, 1989) in (1989) 105 *LQR* 140; see Lord Hofmann in *Kleinwort Benson Ltd v Lincoln City Council* [1999] 2 AC 349 (HL) 401 (discussed by F Wilmot-Smith in chapter 16 of this volume).

its loopholes. There is no need for such spooky jurisprudence.[15]

According to Lord Hoffmann, he is searching for principle and not policy, in the sense in which Dworkin sets out that distinction in *Law's Empire*.[16] Lord Hoffmann has explained further his understanding of this distinction as follows: '[A] principle which entitles a litigant to judgment should not be overridden by judges on ground of utilitarian calculation.'[17]

Dworkin's concept of principle rests on the idea of integrity. He comments that: 'The judge's decision- his post interpretive conclusions- must be drawn from the interpretation that both fits and justifies what has gone before, so far as this is possible.'[18] One critic, James Lee, writing on a different area, has suggested that '[i]f integrity is a question of keeping the faith, then … Lord Hoffmann has heretical tendencies.'[19] Lee argues that Lord Hoffmann's treatment of precedent (in the two cases that Lee discusses[20]) 'seems to view interpretation as a teleological process: reasoning backwards from the desired result (the justificatory principle) and making the cases fit the instant decision'.[21]

This description has resonances with the tax avoidance cases in which Lord Hoffmann has been involved. Lord Hoffmann has even stated, extra judicially, that in developing and applying the *Ramsay*[22] line of cases on tax avoidance, the 'House had to rewrite history in a way which struck some people as a little disingenuous'... and agreed that 'a sleight of hand covered this retreat to constitutional propriety'.[23]

Lord Hoffmann was not alone in this exercise, however. Indeed, the House of Lords in the leading case *of Barclays Mercantile Business Finance Ltd v Mawson* (*BMBF*)[24] was unanimous that the *Ramsay* line of cases had to be reviewed. The process undertaken has been described by Mummery LJ[25] as 'a significant judicial stocktaking of the 'new approach' to the construction of revenue statutes first applied in *Ramsay*'. Mummery LJ recognised that the aim in the report delivered by Lord Nicholls in *BMBF* was to 'achieve some clarity about basic principles' whilst recognising that it was

[15] *Norglen Ltd (in liquidation) and Reeds Rains Prudential Ltd* [1999] 2 AC 1 (HL) 14.
[16] R Dworkin, *Law's Empire* (Oxford, Hart Publishing, 1998) chs 6 and 7.
[17] Hoffmann (1989) (n 14) 143; Dworkin (n 1516) esp 244.
[18] Dworkin (n 15) 239.
[19] J Lee, 'Fidelity in Interpretation: Lord Hoffmann and The Adventure of the Empty House' (2008) 28 *Legal Studies* 1.
[20] The cases discussed by Lee (ibid) are *Barker v Corus* [2006] UKHL 20, [2006] 2 AC 572 (causation in tort) and *Barlow Clowes v Eurotrust International* [2005] UKPC 37, [2006] 1 All ER 333 (dishonest assistance).
[21] Lee (n 19) 5.
[22] *Ramsay* (n 1).
[23] L Hoffmann, 'Tax Avoidance' [2005] *British Tax Review* 197, 202–203.
[24] *BMBF* (n 8). Lord Steyn in *IRC v McGuckian* [1997] 1 WLR 991, [1997] STC 908 (HL) 916 had also been forceful in emphasising that the principle in Ramsay was based on 'an orthodox form of statutory interpretation' and that 'in asserting the power to examine the substance of a composite transaction the House of Lords was simply rejecting formalism in fiscal matters and choosing a more realistic legal analysis'. However it was not until *Westmoreland* was decided in 2001 that the point really took hold.
[25] *Mayes v HMRC* [2011] EWCA Civ 407, [2011] 81 TC 247.

> too much to expect that any exposition will remove all difficulties in the application of the principles because it is in the nature of questions of construction that there will be borderline cases about which people have different views.[26]

Lord Hoffmann would argue, no doubt, that in this process of 'judicial stocktaking', or reassessing the case law, he was seeking the original meaning of the initial case in the chain, which had become distorted. He would say that he, and his judicial colleagues, were only returning to the origins of that case and that it was only the intervening cases that were required a little judicial 're-writing' to make them fit the thesis.

This is plausible, though not in line with the commentary on *Ramsay* at the time of that decision and those immediately following. Whilst their Lordships in *Ramsay* denied creating a new principle, they were intent on establishing a new approach, with Lord Wilberforce stating that '[w]hile the techniques of tax avoidance progress and are technically improved, the courts are not obliged to stand still' and 'it would be an excess of judicial abstinence to withdraw from the field now before us'.[27]

The House of Lords in *Ramsay* came up with the idea of looking at a composite transaction rather than applying the law step by step, and this was developed further in subsequent cases. To many, this looked very like a judicial principle and, if it was not, to what 'basic principles' was Lord Nicholls referring in *BMBF* when he described the wish to give them clarity? Were these really merely the principles of statutory construction?

Despite the fact that Lord Hoffmann and his judicial colleagues claimed they were doing no more than getting back to 'normal' principles of statutory construction in *BMBF*, this has not been operationally straightforward in later cases and arguably, has not proved successful, as explained below. Commentators have persisted in trying to find something more. The courts have also frequently appeared to search for some other prescription to enable them to reach the answer they seek intuitively. There are some members of the judiciary who are prepared to hunt for that something more; a general overriding 'principle'. Others do not think this is appropriate. We might characterise these two views as wide purposive interpretation and narrow purposive interpretation. The supporters of the narrow form look at the wording of the legislation and search for its meaning, whilst supporters of wide purposive interpretation may be prepared to support that search with a judicially created principle of a more general nature. In the tax avoidance context, this latter approach might, for example, involve analysing a transaction as a composite one and then, simply by virtue of the fact that this can be done, applying the legislation to the composite rather than to individual steps. The narrow approach permits this only where the wording and context of the legislation contain signals permitting that mode of application. The wide approach looks for a

[26] *BMBF* (n 8) [27].
[27] *Ramsay* (n 1) 326–27 (Lord Wilberforce).

general principle; the narrow for a specific principle arising from the legislation. Critics of the wide approach would argue that it goes beyond the limits of proper purposive construction into judicial legislation.

The case law in this area highlights the difficulty of finding the narrow principle or statutory purpose when the statutes in question are so complex and the subject matter so artificial in nature. The hunt for a principle of this nature can seem hopeless. The temptation to skip directly to a more utilitarian calculation is then very great indeed and if there is a device such as an apparent general overriding principle that can help the judges to do this it then it is not surprising to find them resorting to that.

The UK GAAR may be seen as an attempt to provide an overriding principle, or set of principles, that can supplement purposive construction to give guidance in this difficult process. It has been argued by some that the judiciary could, and should, have found a way of achieving the same result purely by careful statutory analysis.[28] The GAAR recognises the need for statutory assistance in the crafting of a general principle and giving it legitimacy. Continuing experience suggests that the judicial process alone was never going to achieve a stable case law base. There would always be judicial willingness to be creative from some,[29] coupled with judicial resistance to anything that could be seen as going beyond the narrow purposive approach from others.[30] As Graham Aaronson QC put it:

> Judges inevitably are faced with the temptation to stretch the interpretation, so far as possible, to achieve a sensible result; and this is widely regarded as producing considerable uncertainty in predicting the outcome of such disputes. In practice this uncertainty spreads from the highly abusive cases into the centre ground of responsible tax planning. A GAAR specifically targeted at abusive schemes would help reduce the risk of stretched interpretation and the uncertainty which this entails.[31]

It is entirely consistent with Lord Hoffmann's view of the role of principles that it has been found necessary to introduce a statutory GAAR that legitimates the process of going beyond purposive construction in defined circumstances rather than relying on a judicial rule of uncertain constitutionality.

IV. 'Reality', 'Economic Effect' and 'Commercial Meaning'

[28] See, eg, *Simpson* (n 1).

[29] See, eg, *Tower MCashback LLP 1 v Revenue and Customs Commissioners* [2011] UKSC 19, [2011] AC 457 (*Tower*) and *Flanagan, Moyles, Stennett v HMRC* [2014] UKFTT 175 (TC), where the decisions are supposedly based on purposive construction but also take a great deal of note of the fact that there were pre-ordained transactions and view the facts 'realistically'.

[30] *Mayes* (n 25) above might be seen as the classic example of this resistance, as discussed further below. See also *Hancock v HMRC* [2014] UKFTT 695. Both cases cited Lord Hoffmann's statement (n 23) that 'sometimes there are holes in the net and the courts find that they cannot plug them by appealing to the economic event which, at a higher level of generality, it appears that Parliament wished to tax'.

[31] Aaronson Report (n 2) para 1.7 (iii).

A. The Tax Avoidance Chain of Cases

The judicial role in combating tax avoidance has a long history. The *Ramsay* case referred to above,[32] which some claimed to have established a new judicial approach to tax avoidance, was based on the self-contained legislation designed to tax capital gains.

A somewhat simplified version of the facts in *Ramsay* will help to highlight the issues under discussion here. The taxpayer acquired two assets, one of which (a loan to a subsidiary company) was increased in value at the expense of the other (shares in the subsidiary). The aim was that the profit on the sale of the loan would not be a chargeable gain for tax purposes because it was not a 'debt on a security' within the capital gains tax legislation, but the loss on the shares would be allowable and therefore could be set off against a pre-existing chargeable gain of the taxpayer within the structure of the capital gains tax regime. The overall transaction produced no economic change but there was, if the scheme worked, a tax advantage. The scheme was purchased 'off the shelf': that is, it was not tailor made but was devised and marketed to many taxpayers.

The question was whether gains and losses which ultimately balanced each other out economically could be treated as cancelling each other out for tax purposes, despite the technical argument that the loss was allowable but the gain was not taxable under the legislation. The legislation itself did not refer to the overall economic outcome, but the House of Lords managed to apply the law on the basis that no overall loss had arisen within the meaning of the legislation.[33] Lord Wilberforce stated that:

> The Capital Gains Tax was created to operate in the **real world,** not that of make-belief … To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function.[34]

The idea that the capital gains tax is created to operate in the 'real world' (whatever that is[35]) requires something of a leap. In the UK, capital gains tax is created and governed by a self-contained code with its own definitions of what constitutes a loss and a gain.[36] In truth, the decision in *Ramsay* focuses far more on the fact that it is looking at the scheme as a whole than on a detailed analysis of the statute. The result of this was that most contemporary

[32] *Ramsay* (n 1).

[33] The technical arguments in the case were also held to fail, so that the wider approach was not strictly necessary, but the wider reasoning was clearly expressed as the ratio of the case.

[34] *Ramsay* (n 1) 326.

[35] Lord Hoffmann has expressed doubts about references to 'reality' as discussed below.

[36] TCGA 1992. If one were really looking at 'economic effect' then many economists would argue that capital gains should be treated in the same way as income gains, but that is not what UK policy makers have chosen to do. See J Freedman, 'Treatment of Capital Gains and Losses' in P Essers and A Rijkers (eds), *The Notion of Income from Capital* (Amsterdam, IBFD, 2005).

commentators thought that the case was about introducing a new doctrine to tax law which involved looking at a scheme as whole and disregarding steps. Over the course of the following 15 years, the courts proceeded on that basis, apparently hardening the 'new approach' in *Ramsay* into a judge made rule of some complexity, sometimes know as the 'principle' in *Furniss v Dawson*.[37]

The judicial formulations of the *Furniss v Dawson* principle specified the need to find a pre-ordained, circular, self-cancelling transaction undertaken for no commercial purpose other than obtaining a tax advantage. Each of these factors became something that acquired a gloss and precedents. As the factors rigidified, the formulation became increasingly easy to plan around, as do all firm lines.

It was this outcome that Lord Hoffmann rejected very clearly in *MacNiven v Westmoreland Investments Ltd* in 2001, saying that it looked like an overriding legal principle without regard to the language or purpose of any particular provision.[38] Of course he was right and it is not clear that Lord Wilberforce in *Ramsay* had intended quite such a formulaic development. But getting back to that position after the twists and turns that the courts had taken was not straightforward; hence the need for ingenuity and some rewriting of history. This could be seen as a lack of consistency, but is better explained as a reworking of the case law in a way that sacrificed complete consistency with every case along the chain in order to get back to the origins of the principle, and for the sake of overall coherence of the law and a return to constitutional propriety.[39]

B. Juristic versus Commercial—The 'Supposed Dichotomy'

Following the decision in *Westmoreland,* the problem became how to apply the purposive approach that had supplanted the so-called *Ramsay* principle. Was it purely normal statutory construction or was there a special element in the tax cases still, given the difficulties of finding purpose in tax legislation and the need to inhibit tax avoidance? At this point, the cases threatened to take a wrong turning, partly because Lord Hoffmann was applying an approach that worked for him but was not easily translatable into a general rule of statutory construction based on the wording and context of the legislation. For a time, as explained further below, Lord Hoffmann was taken to have developed an alternative principle requiring *a priori* classification of concepts as 'juristic' or 'commercial'. This was said to come from the legislation itself, and so ostensibly fitted the narrow purposive approach rather than a wider one. But the link with the wording was not always easy to find, leading to a concern

[37] *Furniss v Dawson* [1984] AC 474 (HL).

[38] *MacNiven (Inspector of Taxes) v Westmoreland Investments Ltd* [2001] UKHL 6 [2003] 1 AC 311 (HL) (*Westmoreland*).

[39] Lee (n 19) 5, citing N MacCormick, *Rhetoric and the Rule of Law* (Oxford, Oxford University Press, 2006), is critical of Hoffmann's '*quasi*-Dworkinian reasoning' in the cases he is considering, stating that it relies too much on an individual conception of coherence. In *Westmoreland* (ibid) and the subsequent case of *BMBF* (n 8), however, it was clear that the other members of the House of Lords panel shared Lord Hoffmann's concerns and were prepared to go along with his reasoning, in order to return to a position all members considered to have greater constitutional propriety than the one being claimed by proponents of the judge made principle.

that this arose not so much from a hunt for a principle in the legislation as an application of intuition.

In *Westmoreland* , Lord Hoffmann expressed the view that:

> The innovation in the *Ramsay* case was to give the statutory concepts of 'disposal' and 'loss' a commercial meaning. The new principle of construction was a recognition that the statutory language was intended to refer to commercial concepts, so that in the case of a concept such as disposal, the court was required to take a view of the facts which transcended the juristic individuality of the various parts of a preplanned series of transactions.[40]

Some of those who felt that in *Westmoreland* they had lost the comfort of the *Ramsay* principle as it had developed in its rigid, possibly unconstitutional form, seized upon the dichotomy between the 'commercial' and the 'juristic' interpretation of words suggested in that case as a new 'overriding principle' to be applied. It can be said with reasonable assurance that this was not what Lord Hoffmann had meant at all.[41] He had seen his comments as an explanation of purposive construction, and guidance on how to determine whether the context permitted the court to look at the overall economic effect, but just like the explanation of how to approach these issues given by Lord Wilberforce in *Ramsay*, Lord Hoffmann's explanation too threatened to become formulaic. Unsurprisingly, it very soon became apparent that this was not a formula that could lead to any certainty, since the same word could lead to different conclusions in different contexts.[42] This is obvious when it is seen as part of the exercise of purposive construction, but was puzzling for those seeking a generally applicable rule.

Almost inevitably, therefore, this new formulation began to cause problems. One sparring partner of Lord Hoffmann's in this area, Lord Templeman, described the supposed commercial/juristic distinction as 'reflecting ingenuity but not principle'.[43] The formulation was criticised by the lower courts in *BMBF* and the criticisms reached Hong Kong, where Lord Millett,[44] a progenitor of the original *Ramsay* principle but by this time retired from the

[40] *Westmoreland* (n 38) [32].

[41] Indeed, in a talk to the International Fiscal Association in 2003 Lord Hoffmann reportedly said that 'his judgment in *MacNiven* had been much misinterpreted, to his dismay, as substituting one solve all magic formula (the "pure" *Ramsay* doctrine) for another (the juristic: commercial concept)': see P Way, 'The Ramsay Principle—Where are We Now?' *GITC Review*, Vol III No 2 (2004) <htttp://www.taxbar.com/documents/ramsey_principle_pw_000.pdf> accessed 16 December 2014.

[42] For example, see contemporaneous comment on the contrast between the meaning of 'paid' in *Westmoreland* (n 38) (juristic) and that of 'payment' (commercial) in *DTE Financial Services Ltd v Wilson (Inspector of Taxes)* [2001] EWCA Civ 455, (2001) 74 TC 14 A. A Roycroft, 'And "Payment" Means…', *Taxation* (28 June 2001) <http://www.taxation.co.uk/taxation/articles/2001/06/28/1137/and-payment-means> accessed 16 December 2014.

[43] Lord Templeman, 'Tax and the Taxpayer' (2001) 117 *LQR* 575, 582.

[44] Lord Millet had appeared as the QC for the Inland Revenue in both *Ramsay* and *Furniss v Dawson* and been responsible for introducing some of the more radical ideas into those cases, including references to the US cases

UK courts, was able to intervene from a distance. He took up the point in *The Collector of Stamp Revenue v Arrowtown*,[45] where he commented:

> The supposed dichotomy between legal and commercial concepts has caused great difficulty. In *Barclays Mercantile* neither Peter Gibson LJ nor Carnwath LJ could understand it, and counsel were unable to explain it. Nor is its source discernible. It makes no previous appearance in the many authorities in which *Ramsay* has been applied.[46]

Lord Millet accepted that Lord Hoffmann might have been doing nothing more than supporting purposive interpretation, but he went on to remark that 'his speech has had most unfortunate consequences. It has led to arid debate in an endeavour to fit the statutory language into one or other conceptual category.[47]

On the one hand it could be said that it was unfair to blame Lord Hoffmann for the misunderstandings of the commentators. On the other hand, perhaps a judge should predict that advisers will seize on his every word and might misinterpret what he says, particularly in an area where there is a thirst for certainty and an almost near impossibility of providing such comfort. If decided cases at the highest level do not give adequate guidance to lower courts, tribunals and the officials who have to operate the law on an everyday basis, then even a decision that is right on its facts and specific analysis has failed in a vital function. The commercial/juristic distinction was not a test with a predictive function. In any event, in *BMBF,* the House of Lords, with Lord Hoffmann participating, clarified the position and removed the idea that this description of the analysis of words in a statute was intended to be an overriding principle of some kind.

> *MacNiven* shows the need to focus carefully upon the particular statutory provision and to identify its requirements before one can decide whether circular payments or elements inserted for the purpose of tax avoidance should disregarded or treated as irrelevant for the purposes of the statute. In the speech of Lord Hoffmann in *MacNiven* it was said that if a statute laid down requirements by reference to some commercial concept such as gain or loss, it would usually follow that elements inserted into a composite transaction without any commercial purpose could be disregarded, whereas if the requirements of the statute were purely by reference to its legal nature (in *MacNiven*, the discharge of a debt) then an act having that legal effect would suffice, whatever its commercial purpose may have been. This is not an

---

on form and substance and the step doctrine: see P Millett, 'A New Approach to Tax Avoidance Schemes' (1982) 98 *LQR* 209; J Tiley, 'Judicial Anti-avoidance Doctrines: the U.S. Alternatives' (Pts I and II) [1987] *British Tax Review* 180 and 220. Lord Hoffmann has expressed his view that whilst the House of Lords in *Ramsay* (n 1) did not accept these concepts ('Lord Wilberforce handled them gingerly'), after *Furniss v Dawson* 'it appeared that the full-blooded American doctrine had been imported into the UK': see Hoffmann (n 23) 200.

[45] *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, (2004) 1 HKLRD 77 (*Arrowtown*).

[46] ibid [148].

[47] ibid [150].

> unreasonable generalisation, indeed perhaps something of a truism, but we do not think that it was intended to provide a substitute for a close analysis of what the statute means. It certainly does not justify the assumption that an answer can be obtained by classifying all concepts *a priori* as either 'commercial' or 'legal'. That would be the very negation of purposive construction: see Ribeiro PJ in *Arrowtown* at paras 37 and 39 ...[48]

C. Commercial Meaning and 'Reality'

Despite the fact that the 'commercial'/'juristic' dichotomy failed as a useful tool for providing guidance in tax avoidance cases, it remains important in understanding Lord Hoffmann's approach to statutory interpretation in tax cases. Lord Hoffmann has complained frequently about the tendency of UK tax legislation to resort to a mass of detailed rules rather than putting faith in the courts to recognise economic effect. He has said extra-judicially:

> I am not one of those who heaps criticisms upon parliamentary draughtsmen. I think that they usually do an excellent job in trying to translate their instructions into legally-effective language. It is the instructions that concern me. To understand the general economic effect of transactions which one intends to tax is usually relatively easy. To understand the intricate and multifarious forms which some of them can take is often much more difficult. But the Revenue appear to have no faith in the ability or willingness of the courts to recognise the economic effect beneath the varied forms and often prefer to legislate by reference to form rather than substance. In those circumstances, it is essential that those instructing the draughtsman should have a complete understanding of the way that particular activity is conducted. Before anyone can sit down to draft such a statute, it is necessary to be clear about what the Revenue wish to achieve.[49]

Lord Hofmann recognises that, where the legislation has been drafted by reference to form, it is pointless to look for 'economic principles' or a 'commercial concept' and that very often this is not the fault of the draftsman but the result of a policy failure or confusion, as described at the beginning of this chapter. Tax law is not always based on economic outcome—it may be very artificial at its heart. The fact that Lord Hoffmann sometimes finds he cannot apply a commercial meaning illustrates his recognition of this fact.

One question is how the concept of looking for the commercial meaning of a word (where appropriate in the context) differs from simply overlaying the legislation with an overriding principle requiring the courts to look at 'reality' or 'economic substance'. Lord Hoffmann was at pains to point out in *Westmoreland* [50]that he was not simply talking about 'reality', and he pointed out the dangers of references to 'reality'. Commenting on the speeches in *Ramsay* that refer to the 'real' nature of a transaction he has said:

[48] *BMBF* (n 8) [38].
[49] Hoffmann (n 23) 206.
[50] *Westmoreland* (n 38).

> These expressions are illuminating in their context, but you have to be careful about the sense in which they are being used. Otherwise you land in all kinds of unnecessary philosophical difficulties about the nature of reality and, in particular, about how a transaction can be said not to be a 'sham' and yet be 'disregarded' for the purpose of deciding what happened in 'the real world'. The point to hold onto is that something may be real for one purpose but not for another. When people speak of something being a 'real' something, they mean that it falls within some concept which they have in mind, by contrast with something else which might have been thought to do so, but does not. ... Thus in saying that the transactions in *Ramsay* were not sham transactions, one is accepting the juristic categorisation of the transactions as individual and discrete and saying that each of them involved no pretence. They were intended to do precisely what they purported to do. They had a legal reality. But in saying that they did not constitute a 'real' disposal giving rise to a 'real' loss, one is rejecting the juristic categorisation as not being necessarily determinative for the purposes of the statutory concepts of 'disposal' and 'loss' as properly interpreted. The contrast here is with a commercial meaning of these concepts. And in saying that the income tax legislation was intended to operate 'in the real world', one is again referring to the commercial context which should influence the construction of the concepts used by Parliament.[51]

In other words, 'reality' as an abstract concept is not helpful; it assists only as part of a process of construction with the commercial context influencing the reading of the statute.[52] If the concepts used by Parliament do not permit a construction that accords with the judge's sense of 'reality' then he must abandon 'reality' as he understands it and rely on the construct before him, however artificial that might appear to be in commercial or economic terms.

It might have been hoped that *BMBF* would have settled the position for good, but ironically we have seen yet another 'formula' emerging via the *BMBF* case, and one that refers to 'reality'. The phrase in question, which some have started to turn into a detailed prescription, was cited in *BMBF,* taken from the very *Arrowtown* case that criticised Lord Hoffmann's supposed formula.[53] It is the result, once again, not of the original judges wishing to impose a formula but of the tax bar and other practitioners being eager to adopt one, and subsequent judges accepting this. This formulation came from Mr Justice Ribeiro, who almost certainly did not intend to lay down a prescription for the future but was merely summarising the position as he understood it. Nevertheless, every subsequent tax avoidance case seems to contain this quote: 'The ultimate question is whether the

[51] ibid [40].

[52] ibid [40] and [41]. Lord Hoffmann does not eschew references to economic reality himself, but he uses them within the context of detailed statutory analysis, as in *Jerome v Kelley* [2004] UKHL 25, STC 887, where he examined the history of the TCGA 1992 in detail in reaching his decision about the meaning of some difficult wording on the question of who had made a disposal for capital gains tax purposes.

[53] *Arrowtown* (n 45).

relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.'[54]

This might sound unexceptional enough, and at least has an express reference to purposive construction, but some courts seem to have taken the invitation to review the transaction 'realistically' as taking them considerably further than normal purposive construction would go, despite the fact that they always make sure to refer to the need to analyse the statute.[55] Many of the cases are still heavily influenced by the existence of pre-ordained transactions and circularity and tend towards disregarding transactions or elements of transactions that have no commercial purpose, in reliance on the supposed tests in *Furniss v Dawson,*[56] despite the rejection of these as tests or even principles of construction in *Westmoreland* and in *BMBF*.[57] There is a tendency towards what Lord Hoffmann might call 'utilitarian calculation'.[58] The tension between the narrow and the wider view of purposive construction continues.

V. Going Forward: The Need for Guidance

A. The Limits of Purposive Construction

The rejection of 'spooky jurisprudence' in favour of primacy of construction and a search for principle amounts to a rejection of formulae and judge made tests in tax avoidance cases. Unfortunately, the courts need rather more direction than Lord Hoffmann sometimes admits in his judgments in deciding how to approach the legislation they are applying. Attempts to provide that guidance have backfired or produced judge made rules that have then had to be dismantled and denied. Replacement judicial guidance has caused confusion and uncertainty.

Pure purposive construction of tax legislation without any resort to a gloss or an overriding principle to fill gaps and produce sensible answers may result in some results which run counter to the intuition of the judiciary. The judicial dismay at having to come to such decisions is clear, especially at a time like the present when there is severe criticism of complex tax avoidance schemes. This is particularly apparent where here is a failure of those proposing and producing tax legislation to base the legislation on clear objectives and economic principles. There is sometimes little 'reality' in tax legislation and what is meant by 'reality' can only ever be understood in a given context. If the objectives of the legislation are not properly articulated, the courts, viewing the facts 'realistically', may not ascertain the

[54] ibid [35].

[55] See, eg, *Tower* (n 29). On the question of whether there was 'expenditure' within the meaning of the legislation arising in that case, the Special Commissioner (Howard Nowlan) and the Supreme Court decided against taxpayer, viewing the facts 'realistically', but the judge in the High Court, Henderson J and the Court of Appeal judges would have found for taxpayer, showing the extent of differences in opinion amongst the judiciary in this area. It is notable that Howard Nowlan and Henderson J were both members of the Aaronson Study Group (see n 2) which recommended a GAAR (alongside Lord Hoffmann).

[56] *Furniss v Dawson* (n 37).

[57] *Westmoreland* (n 38) [49]; *BMBF* (n 8) [36]; and more recently n *Hancock* (n 30).

[58] Hoffmann (1989) (n 14).

correct 'reality' for the legislation in question.

The major contribution of Lord Hoffmann's approach to construing tax legislation is not that it provides all the answers, but that it underlines the need for tax legislation to spell out the policy and principles on which it is based in order to give the courts the tools they need to work out the answers. The court cannot be expected to provide a formula to rescue poor legislation. If no underlying rationale based on economic substance can be found at all then the hunt for economic substance in the legislation may require a stretching of the wording of the legislation, or a result which does not fit the scheme of the legislation. In some cases the result may be that the courts retreat behind literal interpretation. This was the outcome in *Mayes,*[59] where Mummery LJ was forced to admit that: 'This is legislation which does not seek to tax real or commercial gains. Thus it makes no sense to say that the legislation must be construed to apply to transactions by reference to their commercial substance.'[60] Toulson LJ concurred but commented that it 'instinctively seems wrong, because it bears no relation to commercial reality and results in a windfall which Parliament cannot have foreseen or intended'.[61]

In this non-technical sense of Parliamentary intention,[62] effect could not be given to the intention of the legislature because of the poor quality of the legislation. To criticise such legislation is not an argument for more detailed legislation to replace it, but rather a plea for tax legislation to give more direction as to underlying policy and to the principles to be applied.[63] Leaving the courts to look for the relevant 'effect' without any such direction leaves the courts with little choice. They must either apply legislation which has an outcome that permits tax avoidance, or they have to create their own solution by stretching the legislation which means leaving policy decisions to the unguided court: a solution that Lord Hoffmann has disavowed.

B. Statutory Intervention: The GAAR

It is consistent with his expressed philosophy that Lord Hoffmann has supported the introduction of a statutory anti-abuse rule, the GAAR. This has now been enacted in the Finance Act 2013[64] to provide the judiciary with properly based authority to go further than normal statutory construction would permit in specified cases and based on articulated principles. Critics argue those principles are too vague, but as member of the Aaronson Study Group, Lord Hoffmann appears to have been happy that they were adequate.[65] Having

[59] *Mayes* (n 25. In addition to *Mayes* and *Hancock* (n 30), see also *DB Group Services (UK) Ltd v HM Revenue and Customs* [2014] EWCA Civ 452, where the Court of Appeal overturned the Upper Tier Tax Tribunal on its application of the *Ramsay* principle and allowed the appeal in favour of the taxpayers.

[60] *Mayes* (n 25) [44].

[61] ibid [101].

[62] For further discussion of the jurisprudential meaning of Parliamentary intention in a tax context see Freedman (2007) (n 1).

[63] Freedman (n 13).

[64] Finance Act 2013 ss 206–215.

[65] The Aaronson Report (n 2) states at para 1.1: 'Subject to one reservation, the conclusions set out in this section, and developed in the rest of this Report, reflect the views of the Advisory Committee. The reservation is

successfully operated similar provisions in Hong Kong, he seems to be content that the principles in the legislation are sufficient to be workable and justiciable.[66] The UK GAAR legislation gives express authority to look beyond the limits permitted by purposive construction and to apply an overriding principle, but it is an overriding principle within carefully defined statutory limits, so not inviting an unrestricted judicial gap filling exercise based on intuition.[67]

The operation of the UK GAAR is not going to be without difficulty, because of the defects in the way the underlying tax law is conceived and formulated, as described by Lord Hoffmann above. Some have suggested that the statutory GAAR is intended to provide a formula to fill the gaps in shoddy legislation.[68] It is true it provides some gap filling tools and expressly allows shortcomings in legislation to be addressed. Yet the GAAR expressly refers the courts to the principles on which the legislative provisions are based and the policy objectives of those provisions. The GAAR requires the underlying legislation to have coherent underlying principles and policy if it is to be truly effective. In this sense it should reinforce the need to produce better tax legislation rather than undermine this objective. As an overriding principle that gives the courts authority to go beyond normal principles of statutory construction, whilst still working within the framework of the substantive underlying legislation, this legislation takes on board Lord Hoffmann's objections to the formulaic version of the *Ramsay* principle produced in *Furniss v Dawson* and gives the courts the tools that they have been unsuccessfully trying to invent for themselves.

VI. Conclusion

Lord Hoffmann has been clear about the power of purposive construction in the context of tax law, as elsewhere, but also about its limitations. Whilst there is much that a judge can do, the legislature and policy makers must work with the judges to give them the tools they need to apply complex tax legislation in the circumstances described above. In the case of tax law, the objectives and underlying principles of the legislation can be severely lacking. One of Lord Hoffmann's most important contributions to tax law has been to rein back the creation

---

that the two members of the Advisory Committee who are serving judges in the United Kingdom (Sir Launcelot Henderson and Howard Nowlan) wish to maintain a position of strict public neutrality on the policy issues discussed in this Report, and therefore on the question whether or not a GAAR should be introduced. They do, however, agree with their colleagues on the Advisory Committee that, if a GAAR is to be introduced, a model of the type recommended in this Report appears to be the most suitable for adoption in the UK.'

[66] See, for example, Lord Hoffmann's judgment in *Commissioner of Inland Revenue v Tai Hing Cotton Mill (Development) Ltd* (FACV No 2/2007) [17] where he praised the Hong Kong GAAR in s.61A of the Hong Kong Inland Revenue Ordinance, Cap 112 as a 'powerful and flexible weapon'. See also [21] where Lord Hoffmann imposes what he sees to be sensible limits on the powers under this legislation.

[67] For more details on the UK GAAR and its operation see J Freedman 'Designing a General Anti-Abuse Rule: Striking a Balance' (2014) 20(3) *Asia-Pacific Tax Bulletin* 167 (International Bureau of Fiscal Documentation). The Aronson Report (n 2) para 5.4 comments that the GAAR comes into action only if 'the arrangement would, on conventional purposive interpretation, succeed in achieving the advantageous tax result which it set out to obtain. The GAAR then provides an overriding statutory principle to which other tax legislation is subject.'

[68] See, eg, Gammie (n 1).

of judge made law that was attempting to deal with a problem that was beyond the ability of the courts to tackle effectively. The judicial developments risked going beyond constitutional propriety and causing confusion. The intervention by Lord Hofmann, together with other members of the judiciary, made clear the need for legislation and the draft produced by the Aaronson Study and the final legislation in the Finance Act 2013 reflects Lord Hoffmann's influence.[69] The legislative framework has been created, but the judiciary will continue to have a major role to play in developing this framework and ensuring that it operates effectively and consistently with both the case law and other legislation. Lord Hoffmann has left his mark not only on the tax case law but also on tax legislation.

[69] The UK legislation shares many features with those of the Hong Kong GAAR, not least the list of factors to be taken into account in deciding whether it applies.