Analysis

Ramsay revisited: six principles

Speed read

With the recent decisions of the Supreme Court in *Hurstwood Properties* and the Court of Appeal in *Bostan Khan,* the courts are again grappling with exactly what it means to construe statutory provisions purposively and what factors should be invoked in arriving at a realistic view of the transaction. The path from the decision in *Ramsay* to where we are now has not been straightforward, but in one sense we have come full circle: we have to look at the purpose of the relevant statute, identify the transactions as a whole and construe their legal effect in light of that purpose. Whilst that test is now clearer than ever, it does not necessarily provide taxpayers with certainty over their tax affairs, as the courts may reach different conclusions based on their realistic view of their facts and the purpose of the legislation.

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Forty years have now elapsed since the original House of Lords decision in the *Ramsay* case (*WT Ramsay Ltd v IRC* [1982] AC 300) and yet it continues to be quoted in what seems to be virtually every tax case (outside VAT) of any importance. It therefore seems appropriate to review the state of play. This is particularly in light of the sad death at the end of May of Lord Millett, who was counsel for HMRC in *Ramsay* and whose judgment in *Arrowtown* [2003] HKCFA 46 (together with that of Ribeiro PJ) has proven to be so influential.

A long and winding road

The path from the decision in *Ramsay* to where we are now has not been straightforward or indeed at times predictable. It led initially to a belief that *Ramsay* was only relevant where there were a number of pre-ordained, circular or lineal transactions; much time was then spent in trying to convince a court that the required degree of pre-ordainment was missing, by introducing an element of commercial uncertainty or some form of time gap. There was also a number of what could be seen as diversions from the central interpretative principles.

The first question raised went to the relevance of whether there was tax mitigation or tax avoidance, on the basis that the *Ramsay* principle could only apply when there was tax avoidance. It is now clear that there is no requirement for a tax avoidance purpose for *Ramsay* to be invoked, although whether there is tax avoidance remains relevant to determining the real nature of the arrangements or transactions.

Secondly, the courts raised the question of whether, following *Ramsay*, it was relevant whether the terms used in the statutory provisions under consideration had a commercial or legal meaning. Discussions on this question arose as a result of Lord Hoffman's comments in *Westmoreland v MacNiven* [2001] STC 237 in which it was held, in favour of the taxpayer, that there had been a payment of interest, notwithstanding the circular flow of funds and the tax avoidance purpose. The distinction drawn was that 'payment' was a legal term which did not require a broader commercial interpretation (and a payment had in fact been made) as opposed to the concept of 'loss', considered in *Ramsay*, which had a wider commercial meaning. This suggestion that there is a distinction between legal and commercial terms does now seem to be a discredited approach with *McNiven* discussed more broadly as acknowledging that the purposive interpretation may well be aligned with the literal one but the starting point remains consideration of the intentions of Parliament.

An opportunity to reset the clock was taken by the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51 (*BMBF*), where, unusually, the court sat as a committee, nearly 25 years after the original *Ramsay* decision. The court aimed to 'achieve some clarity about basic principles'. As a result, wherever *Ramsay* is referred to, the starting point is the principles and approach that were set down by *BMBF*. The case was of course a victory for the lessor taxpayer, in that it was held to have incurred the expenditure in question; the way in which it had funded itself was not relevant in the context of the capital allowances legislation. While it may be invidious to single out parts of the judgment, the key paragraphs could be said to be those at 32 to 36:

> 'The question is always whether the relevant provision of the statute, upon its true construction, applies to the facts as found … It elides the two steps, which are necessary in the application of any statutory provision: first, to decide on a purposive construction, exactly what transaction will answer to the statutory description and second, to decide whether the transaction in question does so. As Ribeiro PJ said in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46, para 35:
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> "the driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically."'

This combination of the purposive interpretation of the statute and the realistic view of the transaction has become the guiding principle behind the approach that the courts have taken since that date in construing tax legislation.

In view of this, it may be questioned why it continues to be the case that the Supreme Court has, on a number of occasions, had to revisit *Ramsay* and explore its boundaries. This was necessary for the Supreme Court in what has become another landmark decision, that of *UBS and DB Group Services* [2016] UKSC 13. In the *UBS* decision, the court had to consider whether employment tax planning involving the issue of securities to employees was effective. At the risk of over-simplification, it was key as to whether the securities were restricted securities. In order to make them restricted securities, what the court termed 'a restrictive condition' was 'deliberately contrived' with 'no business or commercial purpose but solely to take advantage of the exemption'. Given this, the condition could be ignored in determining whether the shares qualified: only provisions which had a commercial or business purpose could be taken into account when forming a realistic view of the transaction.

To the present day

Moving on four or five years to the present day, 2020 and 2021 have seen a further application of these principles across the range of transactions. In the Upper Tribunal decision in *Hannah & Hodgson v HMRC* [2021] UKUT 22, it was held that SDLT was payable on what was in economic terms consideration for the property even though the taxpayers argued that they were selling their house for a five per cent deposit and an annuity. The decision is recent (handed down in February 2021) but it has echoes of some of the original *Ramsay* cases in its references to the annuity being 'artificial, uncommercial' and the fact that 'its cancellation is pre-ordained'. In *Clipperton and another v HMRC* [2021] UKFTT 12, there was held to be a distribution to the shareholders, even though the payment that they received was from an indirect or circuitous route: a company was set up as a conduit to receive the funds and to pay it on. In *Padfield and others v HMRC* [2020] UKFTT 513, the taxpayers entered into a structure involving the use of forward purchase contracts with a third party bank designed to generate a tax loss. They were sent a number of contracts to execute; the transactions were then implemented by the promoter and the third party bank. In deciding that no loss was generated, while the tribunal judge considered the authorities from *Ramsay* onwards, he came back at a number of times to the decision in *Ramsay* itself. The transactions were 'paper' transactions; they had no 'business purpose' and did not exist 'in the real world'.

The Court of Appeal has also chosen recently to focus on *Ramsay* and to discuss its extent. This is in the *Khan* case *(B Khan v HMRC* [2021] EWCA Civ 624), a so-called 'reverse *Ramsay*' case, where the taxpayer, rather than HMRC, has sought to invoke the principle. This was accepted as perfectly permissible, as the principle is of general application. In *Khan*, the taxpayer acquired some shares from the sellers; these shares were then the subject of a buy-back, giving rise to a distribution for tax purposes. The taxpayer did not retain the proceeds of the buy-back; these were passed onto the original sellers of the shares. It was agreed that the original sale and the buy-back formed one composite transaction. The argument run was that in looking at whether the taxpayer was entitled to the distribution, one should therefore step back and look at the net result, i.e. what did the taxpayer ultimately retain. The court rejected this and found that he should pay tax on the share buy-back proceeds even if they were passed on, as part of what in *Ramsay* terms, could be said to be one transaction. One had to look at the distribution itself and the transaction which gave rise to it and see who the shareholder was at that time. Further, it was not possible to read into the legislation that that shareholder had to have control or be ultimately entitled to benefit from the payment. In coming to this conclusion, the court relied on the decision in *Pigott v Staines Investment* [1995] STC 114. In *Pigott*, the court found that the payment of a dividend could not be recharacterised so that it was treated as paid to the end recipient of the money in question: this was not legally possible. Applying this to *Khan*, the distribution could not be treated as having been made to the original shareholders: they were no longer the shareholders.

That takes us to the recent decision of the Supreme Court in *Hurstwood Properties v Rossendale Borough Council and another* [2021] UKSC 16. A key question was whether the SPV to which a lease of the property had been granted was 'entitled to possession' of the property for the purposes of the relevant statutory provisions. Applying broad principles from wider real estate legislation, the Court of Appeal decision had held that the SPV in question had been so entitled and therefore the structure, designed to avoid business rates, succeeded. This was firmly reversed by the Supreme Court. In doing so, the court came to the view that in construing the relevant provision, looking very specifically at the intention of Parliament in introducing it, a person which had no practical or legal ability to exercise its legal right to possession could not be said to be entitled to possession. For someone to be so entitled, it had to be a person which had a real or practical ability to occupy the property or to put someone else into possession. This would not include a SPV that was destined to be put into liquidation or wound up. As a result, the landlord remained in possession.

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Hurstwood should not be seen just as a business rates case: it has been used by the Supreme Court as another opportunity to restate the principles first set down as far as tax advisers are concerned in *Ramsay*.

Six lessons

Where does this significant body of case law (which at times can seem inconsistent) leave us? A number of key principles and lessons can be drawn:

(a) The *Ramsay* principle is essentially not a tax principle: as noted in *Hurstwood,* it is based upon the 'modern purposive approach to the interpretation of all legislation', which had only penetrated the tax world 'at a relatively late stage'.

(b) The starting point is to ascertain the class of facts that are intended to be affected by the charge or exemption. That involves looking at the particular statute and its purpose; that can give rise to two different views of one word, whether that is payment or entitled.

(c) Once the statute has been considered, the relevant facts have to be considered. Where the arrangements involve a number of transactions, this process does not involve considering only the individual transactions but looking at the unity of the arrangements and analysing the whole.

(d) This is particularly the case where steps have been inserted with no business purpose or steps that are designed to obtain the exemption in question or to avoid tax.

(e) While the principle will most often come up on transactions, it can also apply to other matters, such as a stamp duty (despite that being a tax on instruments) and a state of affairs (such as to whether a person is entitled to possession).

(f) While the *Ramsay* principle has generally not been held to be applicable to VAT (which has its own anti-avoidance doctrine stemming from the *Halifax* case (Case C-255/02), it is notable that in the recent decision in *Balhousie Holdings Ltd v HMRC* [2021] UKSC 11, in determining whether there had been a disposal of the relevant property, the court started with *Ramsay* as a general principle of statutory interpretation to be followed regardless of whether there was any suggestion of tax avoidance or the nature of the tax in question.

What is equally important to stress (and was clearly discussed in *Hurstwood*) is that this does not lead to an ability of the courts to stretch the boundaries of what is a sham or to impose an economic substance over form test. It is notable that in all of these cases, even where the transactions are self-cancelling or circular, there was no finding that the transactions were shams; indeed, coming to that conclusion would negate the aim of purposive construction. The long-standing test in *Snook* [1967] 2 QB 786 continues to apply where there is a sham transaction or arrangements; these are transactions designed to deceive third parties. Even in tax avoidance cases, there are genuine transactions and arrangements that fall to be taxed by reference to a realistic view of the facts and the purpose of the specific legislation.

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Equally, while the cases often refer to the economic substance of the arrangements in realistically looking at the facts, the starting point is the legal nature of the transactions themselves and whether they gave rise to the desired tax result. The economic result may be relevant to some degree, particularly where the legislation refers to expressions, such as whether there has been a gain or loss, as intended by the legislation, but that does not mean that the legal nature of the arrangements can be ignored. This is clear from the decision in *Khan*, even though the effect is that a person is subject to tax on amounts which as a result of the composite transaction he did not retain.

In one sense, therefore, we have come full circle back to *Ramsay*: what we have to do is look at the purpose of the relevant statute (in that case, the capital gains legislation), identify the transactions as a whole and construe their legal effect in light of that purpose. That was the task that Lord Wilberforce set himself in *Ramsay*; it was also the task that Supreme Court set itself in *Hurstwood*. Given that it is clearer than ever that it is a general principle of statutory interpretation, we can continue to expect it to be referred to. The downside of this is that a court (even in the same case) may come to two different conclusions, based on their realistic view of their facts and the purpose of the legislation. We have therefore moved away from the uncertainty of what is a pre-ordained transaction to a different form of uncertainty. ■

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