

A HIGH COURT OF JUSTICE (CHANCERY DIVISION)—26TH AND 27TH
JUNE AND 9TH JULY 1973

COURT OF APPEAL—5TH, 6TH, 7TH AND 8TH NOVEMBER 1974
AND 29TH JANUARY 1975

B HOUSE OF LORDS—17TH, 18TH, 19TH AND 20TH NOVEMBER 1975
AND 28TH JANUARY 1976

Commissioners of Inland Revenue v. Goodwin⁽¹⁾
Commissioners of Inland Revenue v. Baggley

C *Surtax—Tax advantage—Counteraction—Bonus issue of redeemable preference shares followed by redemption—Main object to avoid loss of family control through sales to meet estate duty—Whether a commercial object—Married woman not separately assessed—Whether redemption moneys subject to counteraction—Finance Act 1960 (8 & 9 Eliz. 2, c. 44), ss. 28 and 43(4)(g); Finance Act 1962 (10 & 11 Eliz. 2, c. 44), s. 25(4).*

D At 30th April 1963 preference shares in a family company to which s. 28(2)(d), Finance Act 1960, applied were held by the wife of G, and by trustees for the wife of B. In 1951 the company had paid up 44,525 £1 preference shares, which were expressed to be redeemable, by capitalisation of £44,525 from the profit and loss account. The main object of that bonus issue was to provide protection against the possibility of a forced sale of ordinary shares, leading to a loss of 70 per cent. family control, in the event of the death of either of two large shareholders who were both in bad health. In 1958, in order to provide the family with funds to meet prospective estate duty liabilities, and also with a view to obtaining a Stock Exchange quotation for the company's shares and so providing access to funds for a further expansion of its trade, it was decided to make a public flotation of some ordinary shares and for that purpose to convert half the ordinary shares into deferred shares (which would be retained by the family). It then came to light that the preference shares were not in fact redeemable because they had been created by an ordinary resolution, whereas under the articles redeemable preference shares could only be created by a special resolution. There having been no change of shareholdings since they were issued, in August 1958 those shares were converted into deferred shares and £44,525 from the profit and loss account was capitalised and applied in paying up 44,525 6 per cent. £1 redeemable preference shares, in order to put the shareholders into the same position as if the resolution of 1951 had not been defective. G received 13,355 such shares, and on 1st September 1958 transferred them to his wife with the object of safeguarding his family's position in the event of his death. The trustees for the wife of B received 4,450 shares as holders of the same number of 1951 shares. The shares were redeemed on 30th August 1963.

⁽¹⁾ Reported (Ch.D.) [1974] 1 W.L.R. 380; [1973] 3 All E.R. 545; [1973] S.T.C. 456; 117 S.J. 729; (C.A.) [1975] 1 W.L.R. 640; [1975] 1 All E.R. 708; [1975] S.T.C. 173; 119 S.J. 303; (H.L.) [1976] 1 W.L.R. 191; [1976] 1 All E.R. 481; [1976] S.T.C. 28; 120 S.J. 99.

The Commissioners of Inland Revenue gave notice to G and B under s. 28, Finance Act 1960, that the adjustment requisite for counteracting the tax advantage obtained from the foregoing transactions was the computation or recomputation of their respective liability to surtax for the year 1963-64 on the basis that the redemption moneys should be treated as net dividends payable under deduction of tax. On appeal, G and B contended that the relevant transactions were carried out for bona fide commercial reasons or in the ordinary course of making or managing investments and did not have as a main object to enable tax advantages to be obtained; G contended alternatively that he was protected from the application of s. 28 because the shares were issued before the commencement of s. 25(4), Finance Act 1962 (relating to assets belonging to a married woman living with her husband). The Special Commissioners held that the main object of the 1951 bonus issue was a purely commercial one and the obtaining of tax advantages was not a main object, and that the main object of the 1958 issue, being to restore the position thought to have been created in 1951, was also purely commercial; they also held that the redemption itself was carried out for bona fide commercial reasons, viz., to implement the bargain made with the public in 1958.

In the High Court, where it was contended for G on the alternative point that s. 25(4), Finance Act 1962, could not create a tax advantage where the wife had no tax advantage apart from that subsection, it was held (1) that the motives of those who procured the 1951 issue, being to avoid loss of control through sales of shares to pay estate duty, were not commercial, although they were financial, that the 1958 transaction was of a piece with the 1951 transaction, and that there was no independent commercial reason for the redemption; (2) that s. 25(4), Finance Act 1962, treating the property of G's wife for the purposes of s. 28 as if it had been G's, applied to the transactions relating to the shares of his wife.

On appeal, the Court of Appeal held (1) that the retention of family control of a business was capable of being a bona fide commercial reason, and accordingly the Commissioners were justified in concluding that the object of the bonus issue in 1951 was commercial; (2) that their similar conclusion as to the issue in 1958 was also justified, particularly since it was necessary for the success of the flotation, which was to be made with a view in part to the advantage of the company and its business; (3) that the redemption in 1963 could not be regarded in isolation, and on the footing that the 1958 redeemable issue was made for bona fide commercial reasons those reasons covered the redemption; (4) that the question whether it was a main object of the transactions to enable tax advantages to be obtained was a matter of subjective fact, and the Commissioners' finding was one at which they could reasonably arrive.

Held, in the House of Lords, affirming the decision of the Court of Appeal, that the Commissioners had adequate grounds for reaching their conclusion that the transactions referred to in the notice were carried out for bona fide commercial reasons and that none of them had as a main object to enable a tax advantage to be obtained.

A

CASES

(1) *Commissioners of Inland Revenue v. Goodwin*

CASE

Stated under the Taxes Management Act 1970, s. 56, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

B 1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 23rd and 24th February 1970, John Goodwin (hereinafter called "the Respondent") appealed against a notice dated 5th May 1969 served on him by the Commissioners of Inland Revenue under s. 28(3), Finance Act 1960. A copy of the said notice is annexed, marked "A", and forms part of this Case.

C 2. At the same time we heard an appeal by Frank Baggley against a similar notice served on him.

3. Shortly stated, the questions for our decision were whether the said s. 28, as amended by s. 25(4), Finance Act 1962, applied to the Respondent in respect of the transactions described in the said notice, and if so whether the adjustments therein described were appropriate.

D 4. The following witnesses gave evidence before us: (1) the Respondent; (2) Mr. Matthew Henry Marsh F.C.A., a partner in Peat, Marwick, Mitchell & Co., chartered accountants, and formerly of Bourner, Bullock & Co., chartered accountants, who were at the material time auditors to R. Goodwin & Sons (Engineers) Ltd. (hereinafter called "the company"); (3) Mr. Berthold Gottlieb Rose F.C.A., in 1958 a member of the board of directors of Neville Industrial Securities Ltd. (hereinafter called "Neville") and at the date of the appeal hearing chairman of the said board.

5. The following documents were proved or admitted before us:

(1) A copy of the prospectus relating to an offer for sale, dated 19th August 1958, of 540,000 ordinary shares of 2s. each in the company at 4s. per share.

F (2) A schedule of shareholdings in the company between 1951 and 1958.

(3) A schedule of profits between 1949 and 1963 and of balance sheets of the company between 1951 and 1963.

(4) A schedule of quoted market values of the 2s. ordinary shares in the company between 31st January 1963 and 4th June 1964.

G (5) A schedule of shareholdings in the company immediately prior to 30th April 1963.

(6) An extract from the articles of association of the company, as adopted on 18th August 1958.

(7) Copies of the minutes of various meetings of the company's board of directors and of certain special and ordinary resolutions passed at extraordinary general meetings of the company between 2nd April 1951 and 30th April 1963;

H (8) A schedule of the Goodwin family's share of the capital and income of the company before and after the redemption of the preference share capital of the company on the "appointed day" (30th April 1963).

Copies of such of the above as are not annexed hereto as exhibits are available for inspection by the Court if required.

6. As a result of the evidence, both oral and documentary, adduced before us we find the following facts proved or admitted: A

(1) The company was incorporated on 11th October 1935 as a private company with a nominal capital of 15,000 £1 ordinary shares (of which 8,905 were issued) to take over a business of ironfounders and engineers originally established in 1883 by the great-grandfather of the Respondent, John Goodwin, and his sons. The Respondent joined the company in 1946 and was appointed a director in 1954. At all times relevant to the appeal the company was a company to which s. 28(2)(d), Finance Act 1960, applied and in 1958 and 1963 the Respondent was its vice-chairman and assistant managing director. B

(2) On 2nd April 1951 the company's authorised capital was increased from £15,000 to £60,000 by the creation of 45,000 £1 preference shares and a bonus issue ("the 1951 bonus issue") of 44,525 of such shares was made by capitalisation of £44,525 from profit and loss account. The said shares, which were expressed to be redeemable at the company's option at three months' notice at any time after twelve months from their issue, were allotted to the holders of the ordinary shares on the basis of five 6 per cent. preference shares for each ordinary share held. Following the 1951 bonus issue the Respondent held 2,671 ordinary shares and 13,355 preference shares, and the trustees of a settlement of 1st March 1951 in which Mrs. Hilda Margaret Bagglely (daughter of Frank Goodwin hereinafter mentioned and wife of Frank Bagglely—see para. 2 of this Case) had an absolute interest held 890 ordinary shares and 4,450 preference shares. At all times from the formation of the company up to August 1958 all shares in the company were held by or on behalf of the various members of the Goodwin family. C D E

(3) The main object of the 1951 bonus issue was to provide protection against the possibility that, in the event of the death of either John S. Goodwin or Frank Goodwin (father and uncle, respectively, of the Respondent), who were directors of and large shareholders in the company and were at that time both in bad health, the necessity to find considerable sums of money for payment of estate duty should lead to a forced sale of ordinary shares leading to loss of 70 per cent. control of the company by the Goodwin family. At the same time a number of family settlements of shares were made by J. S. and F. Goodwin, including the settlement on Mrs. H. M. Bagglely mentioned in sub-para. (2) above. The possibility of a flotation in 1951 was considered, but rejected because of the company's recent profit record and plant expansion for the future. F G

(4) From 1953 to 1958 the company held 29 per cent. of the share capital of Akron Standard (Engineers) Ltd. ("Akron"), 21 per cent. of the said share capital was held by members of the Goodwin family and 50 per cent. by Union Oxide and Chemical Co. Ltd. ("Union") and its associates. There was a certain amount of inter-trading between the company and Akron.

(5) By 1958 the five-year gift period in respect of the settlements made in 1951 had elapsed and the risk of estate duty liability on a death of J. S. or Frank Goodwin in respect of the shares so settled had passed. However, these two gentlemen still had substantial shareholdings in the company and the increasing profitability of the company between 1951 and 1958 meant that the potential liability for estate duty in the event of the death of any of the directors of the company had also increased. In 1958, with a first object of providing the family, out of the proceeds of a sale to the public of a proportion of their holdings, with funds for payment of prospective estate duty liabilities or to supplement existing funds and with a secondary object of obtaining a stock exchange quotation, with the attendant advantage of access to the capital issues market to provide funds for further expansion of the company's trade, the directors asked Messrs. Bourner, H I

A Bullock & Co., the company's auditors, to consider ways and means of a public flotation of ordinary shares in the company. Messrs. Bournier, Bullock & Co. aforesaid consulted Neville.

(6) Neville advised, *inter alia*, that, in order to enhance the likelihood of a satisfactory response to the proposed public flotation, the company should either sell its interest in Akron or acquire that part of the share capital of Akron not already held by the company, that if the latter decision was taken the preference shares in the company allotted in pursuance of the 1951 bonus issue should not be redeemed for a period of, say, five years, and that provision should be made to render the said preference shares irredeemable during the said period. At a slightly later stage Neville and Messrs. Bournier, Bullock & Co. came to the conclusion that the likelihood of a satisfactory response to the proposed public flotation would be further enhanced, and that a better price would be likely to be obtained for the ordinary shares in the company which were to be offered for sale, if the equity capital of the company were to be split in two, of which one-half would consist of ordinary shares (of which some would be the subject of the proposed public flotation) entitled to immediate dividend rights and the other half (to be retained by the Goodwin family) would consist of deferred ordinary shares which would not be entitled to dividend for a period of, say, five years. The line of thought behind the proposals to defer for a period the redemption of the preference shares and the payment of dividends on half the equity capital was that the acquisition by the company of the 71 per cent. of the share capital of Akron which it did not already hold would involve a heavy expenditure of the company's working capital (in the event £134,900), which would take some time to replace, and that during the period of replacement and of the hoped for further expansion of the company's trade it would be desirable to conserve the company's resources so far as possible while at the same time ensuring payment of a reasonable rate of dividend on the shares offered to the public. It was also decided that the repayment of the preference shares should be linked to the conversion of the deferred shares, and that the rights to be attached to the preference shares and the deferred shares should provide that redemption must precede conversion. These proposals were accepted by the Goodwin family.

(7) Consideration of ways and means of a public flotation had started in February 1958 and final decisions were reached early in May 1958. In the course of subsequent preparations for the public flotation it was noticed in June 1958 by the solicitors acting for Neville, who were engaged in drafting an application to the Treasury for the necessary consents, that the preference shares which were the subject of the 1951 bonus issue were not in fact redeemable as had been thought. The reason was that the resolution of the company of 2nd April 1951 creating the said shares was defective in so far as it purported to make them redeemable, because the said resolution was an ordinary resolution whereas under the company's articles of association a special resolution was required to make any of the company's shares redeemable.

(8) The reaction of the company and its advisers to the discovery that the 44,525 preference shares issued in 1951 were not redeemable was one of "crisis". Urgent consultations ensued, and it was decided that the situation should be remedied by putting all holders of the said shares into the position in which they would have been if the aforesaid resolution of 2nd April 1951 had not been defective. The method chosen to achieve this was to convert the said shares into deferred ordinary shares and to replace them by a new issue of 44,525 £1 redeemable preference shares. This could be done because the old preference shares and the existing ordinary shares were prior to 1958 held by the same persons in the same proportions. The consent of the Treasury to this proposal

was applied for as a matter of urgency and was obtained within some 48 hours. There were five trustee holdings of shares, aggregating around half of the ordinary and preference share capital, and any scheme other than a restoration of the status quo would have been difficult to get agreed by all the beneficiaries and trustees involved. A

(9) In April 1958 the company had purchased for £95,000 from Union and its associates their 50 per cent. shareholding in Akron, and on 18th August 1958 the company purchased for £39,900 from members of the Goodwin family the remaining 21 per cent. of the share capital of Akron. Thereafter the company held the whole of the share capital of Akron. B

(10) At an extraordinary general meeting of the company held on 18th August 1958 other steps were taken in pursuance of the proposal for a public flotation of ordinary shares in the company and of the restoration of the preference shareholders to the position in which they would have been if the resolution of 2nd April 1951 had not been defective. The said steps were, *inter alia*, as follows: (a) the 8,905 £1 ordinary shares were subdivided into 89,050 2s. ordinary shares; (b) the 6,095 unissued £1 ordinary shares were subdivided into 60,950 2s. ordinary shares; (c) the 44,525 £1 preference shares (the subject of the 1951 bonus issue) were subdivided into 445,250 2s. preference shares; (d) the 475 unissued preference shares were subdivided into 4,750 2s. preference shares; (e) the 450,000 2s. preference shares resulting from (c) and (d) above were converted into 450,000 2s. deferred ordinary shares; (f) the company's authorised capital was increased from £60,000 to £225,000 by the creation of (i) 45,000 6 per cent. £1 redeemable preference shares; (ii) 750,000 2s. ordinary shares; (iii) 450,000 2s. deferred ordinary shares; (g) £171,095 was capitalised from the company's general reserve and applied in paying up at par the newly created shares and other shares not already fully paid up, being £44,525 6 per cent. preference shares, £81,095 ordinary shares and £45,475 deferred ordinary shares; (h) new articles of association were adopted, under which, *inter alia*, (i) any or all of the redeemable preference shares referred to at (f) (i) above were made redeemable at the company's option on or after 30th April 1963; (ii) subject to the payment and dividends on the said redeemable preference shares, the profits of the company available for distribution as dividend and resolved to be so distributed as dividend for any period before the appointed day were to belong to the holders of the ordinary shares, the appointed day being defined as 1st May 1963 or the date of redemption of the last to be redeemed of such of the said redeemable preference shares as should have been issued prior to 1st May 1963 (whichever should be the later); (iii) upon the expiration of twelve months after the appointed day the ordinary shares and the deferred ordinary shares were to be amalgamated into one class of ordinary shares ranking *pari passu* in all respects. C
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Copies of the resolutions passed at the said extraordinary general meeting of 18th August 1958 and of extracts from the new articles of association adopted at the said meeting are annexed hereto, marked "B" and "C" respectively, and form part of this Case⁽¹⁾. H

(11) The history of the issued share capital of the company from its incorporation until 18th August 1958 may be shown in the form of a chart as follows:

	6% Preference £1	Ordinary £1	Ordinary 2s.	Deferred 2s.	
Issued for cash or consideration on incorporation:	—	8,905	—	—	I

(1) Not included in the present print.

	6% Preference £1	Ordinary £1	Ordinary 2s.	Deferred 2s.
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Note (a) Bonus allotment 2nd April 1951:	<u>44,525</u>	—	—	—
Conversions and sub-divisions on 18th August 1958:				
Preference to deferred shares:	<u>44,525</u>	→		445,250
Ordinary shares to 2s. shares:		<u>8,905</u>	→ 89,050	—
C				
Note (b) Bonus allotments 18th August 1958:	<u>44,525</u>	—	<u>810,950</u>	<u>454,750</u>
Position after 18th August 1958:	44,525	—	900,000	900,000

Notes

D (a) By capitalisation of £44,525 from profit and loss account. The preference shares were made redeemable at the company's option on three months' notice at any time after twelve months from issue, but it was discovered in 1958 that the resolution creating them was defective, and the shares were in consequence irredeemable.

(b) By capitalisation of £171,095 from general reserve.

E (12) The 44,525 new preference shares, 810,950 new ordinary shares and 454,750 new deferred shares were on 18th August 1958 allotted to the then ordinary shareholders in proportion to their then existing holdings. Of the 6 per cent. £1 redeemable preference shares 13,355 were allotted to the Respondent and 4,450 to the trustees of the settlement of 1st March 1951 in favour of Mrs. H. M. Bagley (see sub-para. (2) above).

F (13) On 19th August 1958 a public offer for sale was made of 540,000 2s. ordinary shares in the company at 4s. per share. A copy of the prospectus relating to the said offer is annexed hereto, marked "D", and forms part of this Case⁽¹⁾.

(14) On 1st September 1958 the Respondent transferred his 13,355 redeemable preference shares aforesaid to his wife, with the object of safeguarding the position of his family in the event of his death.

G (15) On 30th April 1963 all of the 6 per cent. £1 redeemable preference shares issued on or about 18th August 1958, amounting to 44,525, were redeemed for cash at par in order to implement the bargain made with the public in 1958 and to enable the Goodwin family's deferred shares to be converted into ordinary shares. On redemption a capital redemption reserve of £44,525 was created by transfer from profit and loss account.

7. It was contended on behalf of the Respondent:

H (1) that of the transactions listed in the notice (exhibit A) regard should be paid only to (3) (the receipt of the redemption moneys on or about 30th April 1963), since it was from that transaction alone that a tax advantage was obtained;

(2) that the said transaction (3) was carried out for bona fide commercial reasons or in the ordinary course of making or managing investments and did

(1) Not included in the present print.

not have as its main object or one of its main objects to enable tax advantages to be obtained, the object of the redemption of the preference shares issued in 1958 being, in effect, to implement the bargain then made with the public and to enable the deferred shares held by the Goodwin family to become ordinary shares ranking for dividend with the existing ordinary shares; A

(3) that if, contrary to contention (1) above it was proper for regard to be paid also to transactions (1) and (2) in the notice, they too were carried out for bona fide commercial reasons or in the ordinary course of making or managing investments and did not have as their main object or one of their main objects to enable tax advantages to be obtained, the 1951 issue of shares being made to provide against the possibility that in the event of the deaths of either Mr. J. S. Goodwin or Mr. F. Goodwin the necessity to raise large sums to pay estate duty might lead to the loss of 70 per cent. control by the Goodwin family, and the 1958 issue of preference shares being made to restore the status quo as it had been thought to exist following the 1951 issue; B C

(4) alternatively, that the Respondent was protected from the application of s. 28, Finance Act 1960 (as amended by s. 25(4), Finance Act 1962) by s. 25(7), Finance Act 1962, because transactions (1) and (2) in the notice (exhibit A) were carried out before the date (10th April 1962) mentioned in the said s. 25(7); D

(5) that s. 28, Finance Act 1960, as amended by s. 25(4), Finance Act 1962, did not apply to the Respondent in respect of the transactions listed in the notice (exhibit A);

(6) that the appeal should succeed and the notice be cancelled.

8. It was contended on behalf of the Commissioners of Inland Revenue: E

(1) that transactions (1), (2) and (3) in the notice (exhibit A) should be looked at as a whole, as constituting a series of inter-related transactions, and that a tax advantage was obtained in consequence of the combined effect of all the said transactions;

(2) (a) as to transaction (1) in the notice (exhibit A), (i) as to whether there were bona fide commercial reasons, there was no evidence of any commercial danger to the company: no witness had been able to point to any distinction between the reasons for the creation of these bonus shares and the reasons for the creation of the debentures in *Commissioners of Inland Revenue v. Parker*(1) 43 T.C. 396; and that a distinction should be drawn between a bona fide commercial reason, exemplified in *Commissioners of Inland Revenue v. Brebner*(2) 43 T.C. 705, and a mere family reason, exemplified in *Commissioners of Inland Revenue v. Parker* and in the present case; (ii) as to its main object, that this was on all fours with the main object in *Commissioners of Inland Revenue v. Blott*(3) 8 T.C. 101, in *Commissioners of Inland Revenue v. Fisher's Executors*(4) 10 T.C. 302 and *Commissioners of Inland Revenue v. Parker*(5), and was in each and every instance eventually to extract from a company profits in the form of capital so as to avoid surtax; F G H

(b) as to transaction (2) in the said notice, (i) as to whether there were bona fide commercial reasons, no fresh thought had been given in 1958 to any reasons, commercial or otherwise, the sole reason for the issue of fresh redeemable preference shares being to restore what had (erroneously) been believed by the Goodwin family to be a "built-in" and tax-advantageous position, analogous to that which it was the purpose of the parties to achieve in the three above-cited cases of *Blott*, *Fisher's Executors* and *Parker*; (ii) as to its main object, I

(1) [1966] A.C. 141. (2) [1967] 2 A.C. 18.

(3) [1921] 2 A.C. 171. (4) [1926] A.C. 395. (5) 43 T.C. 396.

A this—in the absence of any thought other than the restoration of the above-mentioned tax-advantageous position—was necessarily identical with that of the said transaction (1);

(c) as to transaction (3) in the said notice, that the reasons and the main object must take their colour (i) from what had been done in 1958; (ii) from the fact that the cash which the shareholders eventually received on the redemption

B had for practical purposes been accumulated by the deferment of dividends—which would have been taxable—on the deferred shares;

(3) that s. 25(7), Finance Act 1962, did not protect the Respondent from the application of s. 28, Finance Act 1960 (as amended by s. 25(4), Finance Act 1962);

C (4) that the said s. 28 (as amended by the said s. 25(4)) applied to the Respondent in respect of the transactions listed in the notice (exhibit A);

(5) that the appeal should be dismissed and the notice be confirmed.

9. The following cases were referred to: *Commissioners of Inland Revenue v. Blott* 8 T.C. 101; *Commissioners of Inland Revenue v. Fisher's Executors* 10 T.C. 302; *Commissioners of Inland Revenue v. Parker* 43 T.C. 396; *Commissioners of Inland Revenue v. Brebner* 43 T.C. 705; *Greenberg v. Commissioners of Inland Revenue* 47 T.C. 240; [1971] Ch. 286 (Ch.D.); *Commissioners of Inland Revenue v. Tunncliffe* 47 T.C. 240; [1971] Ch. 286 (C.A.).

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10. We, the Commissioners who heard the appeal, took time to consider our decision and gave in writing on 10th June 1970 a decision covering both the appeal of the Respondent and the appeal of Frank Baggeley (see para. 2 of this Case) as follows:

E (1) These two appeals are against notices dated 5th May 1969 served on the Appellants by the Commissioners of Inland Revenue under s. 28(3), Finance Act 1960. It is not in dispute that the circumstances mentioned in s. 28(2)(d) are present and that (subject in the case of the first Appellant, Mr. Goodwin, to para. (10) below) a tax advantage was obtained by each of the Appellants in consequence of the transactions listed in the notice served on him. The main ground (and in the case of the second Appellant, Mr. Baggeley, the only ground) of appeal is that the "escape clause" in s. 28(1) applies, i.e., that the transactions were carried out for bona fide commercial reasons or in the ordinary course of making or managing investments and that none of them had as their main object or one of their main objects to enable tax advantages to be obtained. The Crown contend that the "escape clause" is inapplicable and that the cases before us are on all fours with *Commissioners of Inland Revenue v. Parker* 43 T.C. 396.

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G (2) It is suggested to us on behalf of the Appellants, on the authority of the remarks of Lord Wilberforce in *Parker's* case, at page 441, that we should take into account only the third transaction listed in the notices, namely the redemption payments made on or about 30th April 1963, which transaction, it is contended, is covered by the "escape clause". Alternatively, if it is appropriate for us to have regard also to the earlier transactions (numbered (1) and (2) in the notices), it is contended that they also are covered by the "escape clause".

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I (3) The passage cited to us from Lord Wilberforce's opinion was directed towards the determination of quite a different question from the one we have to consider, namely, whether or not proviso (i) in s. 28(1) applied, and we do not accept that his observations afford any authority for the proposition that we should have regard only to the transaction of 30th April 1963 (which comprised the actual payment of the redemption moneys) in deciding whether the "escape clause" applies. On the contrary, the remarks of Lord Dilhorne in the same

case, at page 433, in the sentence beginning "That it was so paid . . .", coupled with the requirement of the "escape clause" itself that, where—as in the cases before us—tax advantages are obtained in consequence of the combined effect of two or more transactions, none of the transactions must have as its main object or one of its main objects the obtaining of tax advantages indicates clearly to our minds that we should consider the earlier transactions as well. A

(4) Counsel for the Appellants draws our attention to the following passage from the opinion of Lord Pearce in *Commissioners of Inland Revenue v. Brebner* 43 T.C. 705, at page 715, as indicating the approach we should adopt in reaching a decision on the main ground of appeal: B

"The 'object' which has to be considered is a subjective matter of intention. It cannot be narrowed down to a mere object of a company, divorced from the directors who govern its policy or the shareholders who are concerned in and vote in favour of the resolutions for the increase and reduction of capital. For the company, as such, and apart from these, cannot form an intention. Thus the object is a subjective matter to be derived in this case from the intentions and acts of the various members of the group. And it would be quite unrealistic and not in accordance with the subsection to suppose that their object has to be ascertained in isolation at each step in the arrangements. Admittedly, an object of the carrying out of the broad scheme by way of the resolutions was a tax advantage. But that which had to be ascertained was the object (not the effect) of each interrelated transaction in its actual context, and not the isolated object of each part regardless of the others." C D

(5) We accept that that is the right approach for us to employ. We think that the word "context" in Lord Pearce's opinion is not to be interpreted as necessarily limited to the immediate context consisting of the transactions actually listed in a s. 28(3) notice but should be treated as extending to the whole of the surrounding circumstances. In the appeals before us the evidence clearly shows, to our minds, that the purpose of the 1958 preference share issue was to replace the 1951 preference share issue, in the sense of restoring the status quo ante after the defect in the resolution authorising the 1951 issue had been discovered. We think it proper, therefore, that our consideration should extend to the reasons for the 1951 issue; indeed, it seems to us that the reasons for the 1958 issue cannot be fully appreciated without an examination of the 1951 issue. We understand that both Counsel for the Appellants and the representative of the Crown take this view. E F G

(6) The present cases seem to us to differ from *Brebner's* case in this sense—that, whereas in *Brebner* there was a series of transactions with one overriding main object throughout, in the cases before us a series of transactions took place at various times between 1951 and 1963 of which the object was not precisely the same from beginning to end. We do not, however, consider that this factor detracts from the relevance of the principles to which Lord Pearce gave expression. H

(7) It is not controverted in evidence or argument before us that the main object of the 1951 issue was to provide against the possibility that in the event of the death of either Mr. J. S. Goodwin or Mr. F. Goodwin the necessity of raising large sums to pay estate duty might lead to the break-up of the company⁽¹⁾. The main object of the 1953 transaction in *Parker's* case⁽²⁾ was also to I

(1) In the High Court and above it was agreed that this expression meant "break-up of family control of the company": see pages 596 and 606 *post*.

(2) 43 T.C. 396.

- A provide against possible estate duty liabilities, but it was not argued in that case (as it is here) that any of the transactions were carried out for bona fide commercial reasons. The second alternative "limb" of the "escape clause" (transactions carried out in the ordinary course of making or managing investments) was pleaded before the Special Commissioners in *Parker's* case⁽¹⁾ and rejected by them. But the main ground of argument throughout the various stages of
- B *Parker's* case was whether or not s. 28 applied at all, and we do not regard the decision in that case as inhibiting us from holding, as we do, that the main object of the 1951 preference share issue was a bona fide commercial one, and that the obtaining of a tax advantage was not a main object.

- (8) In the course of preparations for the public flotation of 1958 the resolution authorising the 1951 issue was discovered—by chance—to be defective. We are satisfied on the evidence that the main object of the 1958 preference share issue was to restore the *status quo ante* in this respect. We think that the restoration in itself, and even without regard to the then current intention to embark upon a public flotation of shares in the company, affords a bona fide commercial reason for the 1958 issue of redeemable preference shares, and we find that the obtaining of a tax advantage was not a main object of the 1958
- C transaction.
- D

- (9) The 1963 transaction—the redemption of the preference shares—was in essence the second half of an operation of which the first half was the creation of those shares in 1958 in replacement of the defective 1951 issue. It was stated in evidence that had it not been for the complications of the contemplated public flotation in 1958 (which occasioned the discovery of the defect in the 1951 issue) the 1951 shares would probably have been redeemed in 1958 or 1959. The deferment until 1963 of the redemption of the 1958 preference shares was in our opinion decided upon for bona fide commercial reasons, namely, to facilitate the public flotation. We also hold that the redemption itself (as distinct from its postponement) was carried out for bona fide commercial reasons, in order (as it was expressed in evidence) to implement the bargain made with the public in 1958. Although the redemption of the preference shares necessarily gave rise to tax advantages, we are satisfied that the obtaining of tax advantages was not a main object of the 1963 redemption.
- E
- F

- (10) Our conclusions above are sufficient to dispose of the appeals, but in case it should become material we record our view on a further point which is argued before us in relation only to the first Appellant, Mr. Goodwin. It is common ground that, if s. 28 applies to him at all, it applies only in so far as it is extended by s. 25(4), Finance Act 1962. It is contended on his behalf that he is protected from the operation of s. 25(4) by sub-para. (b) of s. 25(7), which, *inter alia*, precludes s. 25(4) from applying where a transaction or transactions in securities was or were carried out before 10th April 1962. We reject this contention; in our opinion the tax advantage obtained by Mr. Goodwin was obtained in consequence of the combined effect of two or more transactions in securities which were not "carried out" until the redemption moneys were received in April 1963.
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(11) The appeals accordingly succeed and we hereby cancel the notices.

11. The Commissioners of Inland Revenue immediately after the determination of the appeal declared to us their dissatisfaction therewith as being erroneous in point of law, and on 10th July 1970 required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970, s. 56, which Case I have stated and do sign accordingly. Mr. D. E. Barrett, with whom I heard and determined this appeal, has since retired from the public service.
- I

12. The question of law for the opinion of the Court is whether our decision in para. 11 above was correct. A

B. James { Commissioner for the Special
Purposes of the Income Tax
Acts

Turnstile House,
94-99 High Holborn,
London W.C.1. B

15th October 1971

“A”

To: John Goodwin
Hankelow Court C
Hankelow
Crewe
Cheshire

Section 28, Finance Act 1960
(as amended by Section 25(4), Finance Act 1962)

R. Goodwin & Sons (Engineers) Ltd. D

Whereas, on 6th January 1969 the Commissioners of Inland Revenue issued a notification to you, in accordance with subsection (4) of Section 28 of the Finance Act 1960, that they had reason to believe that the said Section 28 (which relates to the cancellation of tax advantages from certain transactions in securities) as amended might apply to you in respect of the transactions described overleaf: E

And whereas you have not exercised the right under the said subsection (4) to make a statutory declaration to the effect that the said Section 28 does not apply to you in respect of the said transactions:

Now therefore the Commissioners of Inland Revenue, being of opinion that Section 28 of the Finance Act 1960 applies to you in respect of the aforesaid transactions, hereby give notice, in accordance with subsection (3) of that Section, that the adjustments described overleaf are requisite for counteracting the tax advantage thereby obtained or obtainable. F

Dated this 5 May 1969

By Order of the Commissioners of Inland Revenue

J. P. Strudwick

Assistant Secretary G

Inland Revenue,
Somerset House,
London, W.C.2.

Subsection (6) of Section 28 of the Finance Act 1960, provides that any person to whom notice has been given under subsection (3) of that Section may by notice *within 30 days*, appeal to the Special Commissioners on the grounds that the Section does not apply to him in respect of the transaction or transactions in question or that the adjustments directed to be made are inappro- H

A piate. If either side is dissatisfied with the determination of the Special Commissioners they may require the appeal to be reheard by the Tribunal constituted under Section 28: there is also a right of appeal to the Courts on a point of law from the decision of the Special Commissioners or of the Tribunal.

B If you wish to appeal to the Special Commissioners, notice of appeal, quoting the above reference numbers, should be sent to the Surtax Office, Companies Division (Share Transactions Section), New Malden House, 1, Blagdon Road, New Malden, Surrey. The date and place of the appeal hearing will be notified in due course by the Clerk to the Special Commissioners.

The Transactions referred to:

C 1. The special resolution of R. Goodwin & Sons (Engineers) Ltd. (hereinafter called "the company") on 18th August 1958 to capitalise the sum of £171,095, part of the company's general reserve, and, *inter alia*, to apply part of that sum to paying up in full 44,525 6% redeemable cumulative preference shares of £1 each, such shares (a) to be distributed amongst the holders of the ordinary shares in the company in the proportions specified in the resolution and (b) to carry rights including the company's right, on giving due notice, to redeem them on or at any time after 30th April 1963.

D 2. The issue to you, on or about 18th August 1958, pursuant to the aforesaid special resolution, of 13,355 of the aforesaid redeemable preference shares and the transfer of those shares from you to your wife, Mrs. Patricia M. Goodwin, on or about 1st September 1958.

E 3. The receipt by your wife on or about 30th April 1963 of £13,355 by way of redemption of her holding of 13,355 of the aforesaid redeemable preference shares.

The adjustments referred to:

F The computation or recomputation of your liability to surtax for the year of assessment 1963-64 on the basis that the said sum of £13,355 should be taken into account as if it were the net amount received in respect of a dividend payable at the date of receipt thereof from which deduction of tax was authorised by subsection (1) of Section 184 of the Income Tax Act 1952 and any assessment or further assessment to surtax which may be requisite to give effect to such computation or recomputation.

(2) *Commissioners of Inland Revenue v. Baggley*

G The material facts in this case were similar to those in the first case, and the contentions of the parties and the decision of the Special Commissioners were the same as in that case, with the exception that the fourth contention advanced on behalf of the Respondent John Goodwin (para. 7(4)) and the countervailing third contention advanced on behalf of the Commissioners of Inland Revenue (para. 8(3)) were not advanced at the appeal of the Respondent Frank Baggley.

H The cases came before Walton J. in the Chancery Division on 26th and 27th June 1973, when judgment was reserved. On 9th July 1973 judgment was given in favour of the Crown, with costs.

D. C. Potter Q.C. and *Patrick Medd Q.C.* for the Crown.

Michael Nolan Q.C. and *Stephen Oliver* for the taxpayers.

I *Commissioners of Inland Revenue v. Horrocks* 44 T.C. 645; [1968] 1 W.L.R. 1809 was cited in argument in addition to the cases referred to in the judgment.

Walton J.—In 1883 the great-grandfather of the Respondent John Goodwin (“the Respondent”) and his sons established a business of ironfounders and engineers. This business was carried on in partnership between various members of the family until 11th October 1935, when a company, R. Goodwin & Sons (Engineers) Ltd. (“the company”), was formed to take that business over. It subsequently did so, and has since continued to carry on, and still in fact carries on, such business. A

The Respondent joined the company in 1946. Immediately prior to 2nd April 1951 the issued shares in the company (namely, 8,905 ordinary shares of £1 each out of an authorised capital of £15,000) were held as to 40 per cent. by J. S. Goodwin, the father of the Respondent, as to 30 per cent. by Frank Goodwin, the brother of J. S. Goodwin and hence uncle of the Respondent, and as to 30 per cent. by the Respondent himself. Neither his father nor his uncle was in good health, and it was realised that in the event of the death of either of them considerable sums would have to be found for the purpose of paying estate duty, possibly necessitating a forced sale of ordinary shares by their personal representatives. This did not suit the family book. The shares in the company had always been held by members of the family, and although it was contemplated that a long-term solution to the estate duty difficulty might be a flotation, which would necessitate the surrender of 30 per cent. of the issued share capital, or thereabouts, to the public, the family did not take kindly to the loss of any part of the remaining 70 per cent. A flotation was not immediately then possible because of the company’s recent profit record and plant expansion plans for the future. B

So two separate and distinct measures were adopted. The Respondent’s father and uncle both made settlements of a number of their shares. The only one with which I am directly concerned is a settlement by Mr. Frank Goodwin of 890 ordinary shares upon his daughter Mrs. Hilda Margaret Baggle, the wife of the Respondent Frank Baggle. The terms of that settlement were such that, for present purposes, it is sufficiently accurate to regard Mrs. Baggle as being absolutely entitled to such shares. The other measure was the capitalisation of a sum of £44,525 from the profit and loss account of the company and its distribution to all the shareholders in the form of 44,525 6 per cent. redeemable cumulative preference shares of £1 each. Of these shares the Respondent received 13,355 and the trustees of Mrs. Baggle’s settlement 4,450. The Cases Stated in these two appeals make it quite clear that the main object of this issue of redeemable preference shares was to provide against the possibility that, in the event of the death of either the father or the uncle, the necessity to raise large sums to pay estate duty might lead to the break-up of family control of the company. The words “family control of” are not to be found in the Cases Stated, but there was no evidence led before the Special Commissioners to the effect that any forced sale of shares would lead, or would be likely to lead, to the break-up of the company itself, and in these circumstances I think it is correct to read the Cases Stated in the foregoing way, as indeed was agreed by both Mr. Potter, for the Crown, and Mr. Nolan, for the taxpayers. C

By the year 1958 the then five-year gift period in respect of the settlements made in 1951 had elapsed, and this had obviously mitigated the estate duty problem. But the father and the uncle still had substantial shareholdings in the company, which had been increasingly profitable between 1951 and 1958, and so a substantial potential liability for estate duty still existed. Accordingly the directors, who by then included the Respondent as well as his father and uncle, set in train the necessary processes to lead to a flotation. There was a secondary object in obtaining a Stock Exchange quotation, since this would give the company access to the capital issues market to provide funds for expansion. D

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(Walton J.)

- A In the course of the normal investigations undertaken for the purpose of the flotation it was discovered that the 1951 redeemable preference shares had not, for technical reasons, been validly issued as redeemable, and were in law irredeemable preference shares. This discovery caused a crisis situation in the company, and as a matter of urgency the decision was taken to leave such existing shares as part of the permanent capital of the company and to make a
- B new issue of 44,525 £1 redeemable preference shares in their place. Since there had been no changes in the shareholdings since 1951 this was a simple matter. Any other scheme not involving the restoration of what had been thought to be the status quo would have been difficult to get agreed by all the beneficiaries and trustees involved. In order to smooth the flotation the redemption of the shares, which would have been expected to have taken place in 1958 or 1959
- C had they been regularly issued in the first place and had there been no flotation, was postponed until the year 1963, and the permanent capital of the company was divided into ordinary shares, which were offered to and taken up by the public, and deferred shares, which were all retained by the Goodwin family interests. Broadly speaking, the deferred shares carried no right to dividend until after the redeemable preference shares had been redeemed, when they
- D would become one class again with the ordinary shares. The Special Commissioners have held that the deferment until 1963 of the redemption of the 1958 preference shares was decided upon for bona fide commercial reasons; namely, to facilitate the public flotation, which duly took place.

- On 1st September 1958 the Respondent transferred the 13,355 shares to his wife. As soon as it was possible to do so, the company redeemed the redeemable preference shares; namely, on 1st May 1963. The Special Commissioners have held that such redemption itself was carried out for bona fide commercial reasons; namely, in order to implement the bargain made with the public in 1958 on the flotation. On 6th January 1969 the Commissioners of Inland Revenue issued a notification to the Respondent in accordance with s. 28(4) of the Finance Act 1960 that they had reason to believe that the said section as amended might apply to him in respect of the following transactions: namely,
- F (1) the company's resolution to capitalise the necessary sums to enable the 1958 issue of redeemable preference shares to be made; (2) the issue to him of 13,355 such shares; and (3) the receipt by his wife on or about 30th April 1963 of £13,355, the proceeds of the redemption thereof. The Respondent did not exercise his statutory right to make a declaration to the effect that s. 28 did not
- G apply to him in respect of these transactions, so that on 5th May 1969 the Commissioners issued a further notice under that section in which they stated that they were of the opinion that the section did apply in respect of the transactions, and giving him notice of the adjustments which were requisite for counteracting the tax advantage which he had obtained. The adjustments referred to were the computation or recomputation of his liability to surtax for the year of assessment 1963-64 on the basis that the said sum of £13,355 should be taken into
- H account as if it were the net amount received in respect of a dividend payable at the date of receipt thereof from which deduction of tax was authorised by s. 184(1) of the Income Tax Act 1952 and any assessment or further assessment to surtax which might be requisite to give effect to such computation or recomputation. *Mutatis mutandis*, and with the substitution of the figure of £4,450
- I for £13,355, the same notices were at the same time given to the Respondent, Frank Bagley, in respect of the redemption of his wife's holding of redeemable preference shares in the company, which it will be recalled was an original and not a transferred holding. No point has been taken upon the suitability of the proposed adjustments if the Commissioners are correct in their contention that s. 28 applies.

(Walton J.)

The relevant parts of that section are as follows:

"(1) Where—(a) in any such circumstances as are mentioned in the next following subsection, and (b) in consequence of a transaction in securities or of the combined effect of two or more such transactions, a person is in a position to obtain, or has obtained, a tax advantage, then unless he shows that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained, this section shall apply to him in respect of that transaction or those transactions . . . (2) The circumstances mentioned in the foregoing subsection are that . . . (d) in connection with the distribution of profits of a company to which this paragraph applies, the person in question so receives as is mentioned in paragraph (c) of this subsection such a consideration as is therein mentioned."

That throws us back to para. (c), and the material parts of that are:

" . . . a consideration which either is, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend, . . . and the said person so receives the consideration that he does not pay or bear tax on it as income."

I should also read s. 43(4)(g) of the Finance Act 1960, which is in the same Part of the Act as s. 28. That reads:

"In this Part of this Act . . . (g) 'tax advantage' means a relief or increased relief from, or repayment or increased repayment of, income tax, or the avoidance or reduction of an assessment to income tax or the avoidance of a possible assessment thereto, whether the avoidance or reduction is effected by receipts accruing in such a way that the recipient does not pay or bear tax on them, or by a deduction in computing profits or gains".

It is common ground that the company is a company to which s. 28(2)(d) applies. It is also common ground that, if the appropriate sums had not been capitalised, they would have been available for distribution by way of dividend. It is equally common ground that none of the transactions here in question had as its main object, or one of its main objects, the enabling of tax advantages to be obtained. It has not been suggested that the transactions were carried out in the ordinary course of making or managing investments. So this common ground leaves for solution the simple but difficult question: were such transactions carried out for bona fide commercial reasons?

Neither Mr. Potter nor Mr. Nolan was willing to attempt a definition of the vital word "commercial". After some initial inclination to restrict the word to buying and selling, Mr. Potter finally plumped for the parameters of the word "commercial" being found in the market place. Mr. Nolan would paraphrase the word as equivalent to "business". The matter is not without authority, both inside and outside s. 28 itself. In *Bulmer v. Commissioners of Inland Revenue*⁽¹⁾ 44 T.C. 1 certain complicated arrangements made by some shareholders in a particular company with a view to defeating any takeover bid for its shares were held, albeit in the context of the "settlements" legislation of the Income Tax Act 1952, to be bona fide commercial transactions. Basically,

(1) [1967] Ch. 145.

(Walton J.)

- A the transactions were: the incorporation by a third party of a subsidiary company and a loan to that subsidiary at a commercial rate of interest; a sale by the shareholders of their shares in the company to the subsidiary, but with an option to repurchase them at the same price at the end of the day; and an obligation on the subsidiary to apply all surplus income in the purchase of additional shares in the company, which would ultimately go to the original shareholders. I think I obtain very little guidance from that case. It seems to me that, giving "commercial" even the most limited meaning which it can bear, every step and provision was nevertheless fully "commercial".

- In *Hague v. Commissioners of Inland Revenue*(¹) 44 T.C. 619 it was s. 28 itself which was in question, but the nub of the argument went off on other matters. Nevertheless, by implication the Special Commissioners held—and, it was accepted by Cross J. and all the members of the Court of Appeal, rightly held—that the return of surplus capital which was genuinely in excess of the company's requirements by means of a bonus issue followed by a reduction of capital was effected for bona fide commercial reasons. It is perhaps fair to notice that it was accepted that one of the factors influencing the directors was a preference expressed by some stockholders for a liquidation, it being expected that a payment out would satisfy them. However, in that case it was also held by the Special Commissioners that one of the main objects of the transaction was the obtaining of a tax advantage, so that the case really went on that point. Once again, I think I get very little help from that case. The situation, as I see it, was that the directors of the company had two possible courses of action when the reorganisation of the company threw up a very considerable sum which was no longer going to be required directly for the financing of its business. The company could either retain the cash and invest it, or could return it to the shareholders. Either course was, I think, a course which could be taken "commercially"—here meaning in accordance with the usages of directors placed in that position, or according to usual business practice.
- F The last of these cases, and clearly the most important because it is a decision of the House of Lords upholding the transactions in question as being entered into for bona fide commercial reasons, is *Commissioners of Inland Revenue v. Brebner*(²) 43 T.C. 705. In this case the directors of the company concerned were worried about its falling into the hands of a person who was anxious to make a takeover bid and close down its operations. This would have been disastrous to the directors in two ways. First of all, they would have lost the company as a source of supply of coal to the ships belonging to other companies in which they were interested. Secondly, the company was giving these other companies exceedingly favourable credit terms which no other company would have done. So they borrowed the money to make a takeover bid themselves, which they did (although not all the shareholders accepted), and they were then faced with the necessity of making repayment, since it had been part of the terms of the loan that repayment should be made fairly promptly. By means of a capitalisation issue followed by a reduction of capital, the sum of £75,000 was extracted from the company and used to repay the loans. The method finally employed for extracting this sum from the assets of the company had been left to the accountant. The precise method was left to him, and the securing of a tax advantage was not a consideration which was ever taken into account. On these facts the House of Lords, confirming the Court of Session, unanimously held that the decision of the Special Commissioners that the

(1) [1969] 1 Ch. 393.

(2) [1967] 2 A.C. 18.

(Walton J.)

transactions in question had been entered into for bona fide commercial reasons was unassailable, although a decision the other way would have been equally unassailable. The decision appears to me logical and inevitable. The bona fide commercial reason actuating the directors and shareholders who implemented the scheme was to preserve the company as, putting it very crudely, a cheap source of supply of coal for other companies in which they were interested as shareholders and directors. If this is not a bona fide commercial reason, it is difficult to know what would be. But both Mr. Potter and Mr. Nolan attempted to extract far more from the *dicta* in that case for their own respective benefits than I think they are legitimately entitled to obtain.

Two points which emerge from the decision are not in issue. The first is that the "bona fide commercial reason" has to be found in the minds of those who carry out the challenged transaction in securities: see *per* Lord President Clyde, 43 T.C., at page 713A, *per* Lord Pearce, at page 715B, and *per* Lord Upjohn, at page 717G. The second is that what is in reality all one transaction has to be viewed as a whole. The Crown in that case was attempting to break the transaction up into two parts—the takeover bid and the borrowing of the money for that purpose as one part, and the bonus issue and redemption as another part—and to urge that as regards the second part there was no bona fide commercial reason for the extraction of money from the company but purely the obtaining of the tax advantage which was in question. The House would have none of it. Undoubtedly, however, the Special Commissioners phrased their findings as to the relevant object in the following terms: "to preserve the company in the line of business which it had carried on for many years; a business, moreover, which had good prospects of continuing profitably." Mr. Potter fastened upon this precise wording to say that there was to be found the commercial purpose; namely, the mere preservation of the company as a continuing entity considered purely *in vacuo*. One was preserving the trade of the company, and that was the commercial purpose. His object in so submitting was, of course, to attempt to confine the ambit of commerciality to the narrowest possible one, but I regret that I cannot accept it. The commerciality of the transaction lay, as I have stated, in the preservation of the source of supply of cheap coal for the benefit of those who engaged in the transactions in securities, not for the benefit of those who were employed in the company, or of trade generally. I am not surprised that this is not spelled out in so many words in that case: it underlay the whole of it, and was the background against which the whole debate raged. Mr. Nolan, on the other hand, fastens on the words of Lord Pearce at page 714, where, after dealing with the contentions of the Crown, he proceeds: "But, in my opinion, such analysis and isolation would be wrong and would destroy the opportunity of arriving at a just and sensible conclusion which the subsection was intended to provide." Mr. Nolan says that those words show that s. 28 ought to be so read as to produce a just and sensible solution in all cases, and that means that the "innocent" (his choice of wording) who have not set out upon a tax avoidance scheme should be saved. I regret I cannot accept this submission either. I think that all Lord Pearce was saying was that in cases where commercial motives are in issue one must look at the whole of the facts in broad perspective to see what they really do add up to. I do not think he was in any way intending to lay down some special kind of criterion for the construction of s. 28.

Applying the guidance to be obtained from the foregoing cases, it appears to me that the real question I have to answer is: What were the motives of those who procured the 1951 issue of redeemable preference shares? Were they in

(Walton J.)

- A any sense commercial? I do not think that they were. Their motives were to make provision for estate duty, and so avoid a sale, or at any rate a forced sale, of shares in the company, and the loss of control which would go with it. This is obviously a prudent and intelligent thing to do, but I can see no "commercial" motive. The motive is properly to be labelled "financial". Steps were taken to meet an expected financial impost (in the shape of estate duty)
- B in the least expensive manner, so as to retain as much as possible of this profitable company in the family. I must point out that there was no suggestion that the preservation of the livelihoods of the directors—or rather of the surviving directors—was in any way thought to have been endangered if the family lost "70 per cent. control". Indeed, this of course would be the wrong percentage to consider for this purpose. In such a case, the retention of control might well have a commercial motive—the preservation of the family's jobs.
- C I say no more about such a possibility, but that case is not this case. The sole proffered commerciality here turns out on analysis to be purely financial. I think it is correct to draw a distinction in this context between "commercial" and "financial", in that the only other escape route under the proviso to s. 28(1) is "the ordinary course of making or managing investments"; that is to say, a financial operation. If "commercial" included "financial" in the present context, the expression of this escape route would have been otiose.

- I do not think the situation was in any way radically altered by the 1958 transaction. It was argued by Mr. Nolan that, although undoubtedly there were estate duty dangers still present (as witness the fact of the flotation) at that time, the main reasons for the 1958 issue were commercial, in the sense
- E that the new issue was designed to prevent disagreements amongst the shareholders and to put right the disadvantage under which they found themselves when they realised that they had only irredeemable preference shares. The Commissioners accepted—and I think they were undoubtedly correct in so doing—that the broad general purpose of the 1958 transactions was to restore what was thought to be the *status quo ante*. There was really no independent
- F motive operating, in my opinion, of a sufficient nature to render the transaction commercial when its real object was to restore an issue of shares created for financial and not commercial reasons. I think that the suggestion that the 1958 issue is to be considered as a separate transaction justifiable on the basis of reasons independent of the reasons for the 1951 transaction is not a proper approach to the matter. I think that, approaching the matter broadly, in the
- G same manner as Lord Pearce approached the problem in *Commissioners of Inland Revenue v. Brebner*(¹), the 1958 transaction is all of a piece with the 1951 transaction.

- Finally, there is, of course, the actual redemption itself, which was the transaction actually conferring the tax advantage; until then, all that had happened was that the shareholders had received pieces of paper. Such redemption was, however, *in gremio* the original issue of shares: it was only the day of redemption following the night of the issue, and following as inevitably. Some attempt was made to suggest that such redemption was effected for a commercial reason in that it implemented a bargain made with those who accepted the offer of shares on the public flotation. This will, however, not hold water. It was not part of the bargain with such shareholders that the preference shares should be redeemed; they took their shares subject to that already existing right. There might have been some basis for saying that the postponement of the redemption was effected for commercial reasons—indeed,

(¹) 43 T.C. 705.

(Walton J.)

I think that it was; so that the public issue should go better, the public image of a company which makes an unsuccessful flotation being very poor, with a consequent backlash on its trade—but this is clearly not sufficient for the purposes of the Respondent. A

Accordingly, I have come to the conclusion that the true and only reasonable conclusion which can be arrived at upon the facts found by the Special Commissioners contradicts their own determination, and I am therefore entitled and indeed bound to set it aside so far as this point goes. This is sufficient to determine the appeal in the case of Frank Baggley, which must be allowed accordingly, but not wholly sufficient in the case of John Goodwin, as will shortly appear. B

But I think it is interesting to observe that in *Commissioners of Inland Revenue v. Parker*(1) 43 T.C. 396, which is the case which first opened the eyes of the profession to the full extent of the scope of s. 28, where the bonus issue of debentures in question in that case had been effected for precisely similar reasons as the bonus issue of preference shares in the present case, it was never argued that the transactions had been entered into for commercial reasons, only that they had been entered into in the ordinary course of making or managing investments. I cannot help feeling that if the contentions of the taxpayer in the present case had been correct, the point would have been taken then by the extremely eminent leading Counsel who appeared on the taxpayer's behalf there. C D

I now turn to the final point. It was decided in *Hague v. Commissioners of Inland Revenue* 44 T.C. 619 that, where the taxpayer had transferred some of the capitalised securities which were later paid off by the company to his wife, since she was not assessable to tax, she did not receive a tax advantage by reason of the payment. Meanwhile, to meet this point s. 25(4) of the Finance Act 1962 was passed. This reads: E

“In the case of a man and his wife living with him (whether or not she is separately assessed to tax), the said section twenty-eight shall be treated as applying to him in respect of any transaction or transactions as it would apply if any property, rights or liabilities of the wife were his property, rights or liabilities in relation to which she had acted only as nominee for him, and shall be treated as applying to the wife in respect of any transaction or transactions as it would apply if any property, rights or liabilities of the man were her property, rights or liabilities in relation to which he had acted only as nominee for her: Provided that no adjustment made under subsection (3) of that section by reference to any transaction or transactions to counteract any tax advantage shall by virtue of this subsection be so made that a person bears more tax than if the transaction or transactions had not had as a consequence that any relief or increased relief from, or repayment or increased repayment of, income tax, or any deduction in computing profits or gains, was obtained or obtainable, or that the way in which receipts accrued was such that the recipient did not pay or bear tax on them.” F G H

Mr. Nolan has argued that this section can be applicable only where there is already an existing tax advantage, and that it cannot create one. Hence, he says, as s. 28 is not applicable anyway, there being no tax advantage to the wife, the amendment to s. 28 cannot apply so as to create a tax advantage. To this Mr. Potter replied that the amendment to s. 28 was as much an integral I

(Walton J.)

- A part thereof as if it had originally been enacted therein, and that one could not isolate parts of s. 28: one had to apply the section as a whole as amended, and, so applying it, the property of the Respondent's wife (i.e., the shares here in question) must be treated as if they were the Respondent's own property, and if that were the case he would have obtained a tax advantage and so s. 28 does apply so as to counteract that advantage. In argument I ventured to characterise this as a "chicken and egg" situation, but I am quite clear that the riddle is to be solved in the manner indicated by Mr. Potter. I would also, for the record, state that, as regards that part of s. 25(4) of the Finance Act 1962 which deems the husband's property to be the wife's, Mr. Potter was unable to improve upon the explanation thereof which he proffered to Pennycuik V.-C. in *Green v. Commissioners of Inland Revenue*⁽¹⁾ (1972) 33 T.R. 158. That case certainly shows that the combined effect of the two provisos is not to notionally revest the property in the wife for tax purposes.

I have therefore come to the conclusion that the Respondent taxpayer fails in the first appeal upon the second point as well as the first point, and that accordingly both appeals fall to be allowed.

- D **Medd Q.C.**—In those circumstances, I wonder if your Lordship will order that the appeals should be allowed with costs? I think the consequential Order your Lordship makes is that the notices under s. 28 should be restored, and that is all.

Walton J.—Mr. Nolan, I think that would be right?

Nolan Q.C.—That would follow, my Lord.

Walton J.—So be it.

- E **Medd Q.C.**—I am much obliged, my Lord.

The taxpayers having appealed against the above decision, the case came before the Court of Appeal (Russell, Stamp and Scarman L.JJ.) on 5th, 6th, 7th and 8th November 1974, when judgment was reserved. On 29th January 1975 judgment was given unanimously against the Crown, with costs.

- F **Michael Nolan Q.C.** and **Stephen Oliver** for the taxpayers.

D. C. Potter Q.C. and **Brian Davenport** for the Crown.

The following cases were cited in argument in addition to those referred to in the judgment:—*Ransom v. Higgs* 50 T.C. 1; [1973] 1 W.L.R. 1180; *Sun Life Assurance Society v. Davidson* 37 T.C. 330; [1958] A.C. 184.

- G **Russell L.J.**—The judgment I am about to deliver is the judgment of the Court.

These appeals are from decisions of Walton J. on appeals by the Crown by way of Case Stated from decisions of the Special Commissioners. The case below is reported at [1974] 1 W.L.R. 380(2), to which reference may be made. The main point in both cases is the same, and an additional point is taken in the

- H *Goodwin* case.

The cases stem from assessments made upon the taxpayers by way of counteraction or cancellation of tax advantages under s. 28 of the Finance Act

(1) T.C. Leaflet No. 2456. To be published later in this volume. (2) Page 596 *ante*.

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1960 in respect of the year 1963-64. In the case of *Baggley*, the relevant transactions relied upon were: (1) resolution of the company on 18th August 1958 to capitalise, *inter alia*, £44,525 of the company's general reserve and apply that sum in the bonus issue to ordinary shareholders of 6 per cent. redeemable preference shares of that nominal amount in certain proportions, such shares being redeemable at the option of the company after 30th April 1963; (2) the issue accordingly to a trustee for Mrs. Baggley of 4,450 of those shares; and (3) the receipt by the trustee of £4,450 on the redemption on 1st May 1963 of those shares. In the case of *Goodwin*, the relevant transactions relied upon were: (1) the same resolution to create and issue redeemable preference shares; (2) the issue to Mr. Goodwin on 18th August 1958 of 13,355 of those shares and their transfer by him to his wife on 1st September 1958; (3) the receipt by his wife on 1st May 1963 of £13,355 on the redemption of those shares. As to (2), in fact the shares were allotted to Mr. Goodwin and renounced by him in favour of his wife as a gift: but it was agreed that that machinery made no difference. On the main point, stated shortly, the question is whether the taxpayer establishes (i) that the transactions were carried out either (a) for bona fide commercial reasons or (b) in the ordinary course of making or managing investments, and also establishes (ii) that none of the transactions had as their main object, or one of their main objects, to enable tax advantages to be obtained. In each case the Special Commissioners concluded that the transactions were carried out for bona fide commercial reasons, and also that none of them had as the, or a, main object to enable tax advantages to be obtained.

The history of these redeemable preference shares starts in 1951. The business of the company was that of engineers and iron and steel founders, originally established in 1883 by the great-grandfather of Mr. Goodwin and Mrs. Baggley and his sons. It was throughout a family business: in 1935 the company was formed and took over the business: it remained a family company. At 1951 the issued share capital was 8,905 £1 ordinary shares: of these 40 per cent. belonged to Mr. Goodwin's father, J. S. Goodwin, and to trustees of family settlements made by J. S. Goodwin: 30 per cent. belonged to Mr. Goodwin's uncle, Frank Goodwin, and to trustees of family settlements made by Frank Goodwin: and 30 per cent. belonged to Mr. Goodwin. Under one of Frank's settlements 890 shares were held by the trustee for Mrs. Baggley, his daughter, absolutely. Neither J. S. Goodwin nor Frank Goodwin were in very good health, and the family were anxious lest on their respective deaths money for estate duty on their actual holdings of respectively 867 and 892 shares, and perhaps also on the shares in their settlements (which were still vulnerable as gifts *inter vivos*), could only be made available by finding purchasers for shares in the company from outsiders. It is, we think, clear from the findings that the family was anxious to retain the maximum possible percentage control of the shares in the company consistent with what was envisaged as a possible or probable future offer to the public of 30 per cent. of the share capital of the company, for which offer the condition of the company was not then suitable. Accordingly, in 1951 the company increased its capital by £45,000 by the creation of 45,000 6 per cent. preference shares intended to be redeemable by the company on three months' notice after twelve months, and by capitalisation of £44,525 from profit and loss account made a five for one bonus issue thereof to the holders of ordinary shares.

As to this transaction, the Special Commissioners found as follows (in para. 6(3) of the Case):

"The main object of the 1951 bonus issue was to provide protection against the possibility that, in the event of the death of either John S.

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- A Goodwin or Frank Goodwin (father and uncle, respectively, of the Respondent), who were directors of and large shareholders in the company and at that time both in bad health, the necessity to find considerable sums of money for payment of estate duty should lead to a forced sale of ordinary shares leading to loss of 70 per cent. control of the company by the Goodwin family. At the same time a number of family settlements of shares were made by J. S. and F. Goodwin, including the settlement on Mrs. H. M. Bagglely mentioned in sub-para. (2) above. The possibility of a flotation in 1951 was considered, but rejected because of the company's recent profit record and plant expansion for the future."

Further, in their reasons, para. 10(7), they stated:

- C "It is not controverted in evidence or argument before us that the main object of the 1951 issue was to provide against the possibility that in the event of the death of either Mr. J. S. Goodwin or Mr. F. Goodwin the necessity of raising large sums to pay estate duty might lead to the break-up of family control of the company."

And they held that the main object of the 1951 bonus preference share issue was a bona fide commercial one and that the obtaining of a tax advantage was not a main object.

- D In 1958 the directors sought advice on a public flotation of ordinary shares. The first object, as found by the Special Commissioners, was that of providing the family, from a sale to the public of a proportion of their holdings, with funds available to meet prospective estate duty liabilities, and a secondary object of obtaining a Stock Exchange quotation with the attendant advantage of access to the capital issues market to provide possible funds for further expansion of the company's trade. After a good many varying suggestions, the scheme evolved for a public flotation was as follows, accepted by the Goodwin family and the trustees of the settlements: (1) acquisition by the company of the outstanding 71 per cent. shareholding in a company ("Akron") so as to make it a 100 per cent. subsidiary; (2) the 1951 bonus issue of preference shares to be made irredeemable for a period of some five years to enable expanding trade to replace the substantial sum (some £130,000) of working capital required for the Akron acquisition; (3) half the ordinary shares in the company to be converted into deferred ordinary shares, the offer to the public to be made out of the unconverted ordinary shares: the deferred ordinary shares to remain as such until after the redemption of the 1951 preference shares.

- G At this late stage it was discovered that owing to a technical defect in their creation the 1951 preference shares were not redeemable. As the Special Commissioners say (in para. 6(8) of the Case), the reaction of all concerned was one of "crisis". After consultations "it was decided that the situation should be remedied by putting all the holders of the [preference] shares into the position in which they would have been if [the 1951 issue] had not been defective."
- H This was done, first, by converting the 1951 preference shares into deferred ordinary shares. The company then capitalised the sum of £171,095 from its general reserve and applied that sum in paying up at par: (a) 44,525 out of 45,000 newly-created £1 6 per cent. redeemable preference shares; (b) 81,095 of previously unissued (6,095) and newly-created (75,000) ordinary shares; (c) 45,475 of previously unissued (475) and newly-created (45,000) deferred ordinary shares, the 475 representing the converted unissued 1951 preference shares. The capital structure of the company for the purpose of the public flotation was thus: issued ordinary shares £90,000, of which a proportion

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(£54,000) was to be offered to the public: issued deferred ordinary shares, £90,000: issued 6 per cent. redeemable preference shares, £44,525: unissued redeemable preference shares, £475. The redeemable preference shares were redeemable at the company's option after 30th April 1963. The deferred ordinary shares were to rank *pari passu* as one class with the ordinary shares only after twelve months from the redemption of the preference shares. (We have for simplicity ignored subdivision of £1 shares into 2s. shares.) In this connection the Special Commissioners remarked:

"There were five trustee holdings of shares, aggregating around half of the ordinary and preference share capital, and any scheme other than a restoration of the status quo would have been difficult to get agreed by all the beneficiaries and trustees involved."

By "restoration of the status quo" was meant, of course, the putting of the 1951 preference shareholders in the situation of redeemability within a measurable time. We can well understand the view thus expressed by the Special Commissioners. Trustees of a settlement might on the one hand well be prepared on behalf of their beneficiaries to adopt a scheme for partial public flotation which involved acquisition of the Akron company with postponement of expected redemption of 6 per cent. preference shares and some acceptance of deferred ordinary shares, but on the other hand jib at a scheme which left the preference shares irredeemable.

On 30th April 1963 the 44,525 of the 1958 redeemable preference shares were redeemed for cash, and in due course the deferred ordinary shares became ordinary shares. The Special Commissioners stated that this redemption was "in order to implement the bargain made with the public in 1958". This must be a misconception as stated: there was no obligation towards the public ordinary shareholders to redeem the preference shares, who indeed had been offered the carrot that the preference shares would not be redeemed for about five years and that the deferred ordinary shares would not rank for dividend until after the redemption. We think what is meant by the phrase is that what was done was that which was envisaged in the offer to the public: though it is true to say that in the recital of the contentions for the taxpayer in para. 7(2) of the Case Stated there occurs again the phrase "the object of the redemption . . . being, in effect, to implement the bargain . . . made [in 1958] with the public . . ." Moreover, from para. 10(9) it appears that this expression comes from evidence given. As we have already indicated, the Special Commissioners formed the view that the main object of the creation and issue in 1951 of the preference shares was to avoid the necessity of break-up of family control of the company due to the exigencies of estate duty, that this was a bona fide commercial reason for that issue, and that the obtaining of a tax advantage was not a main object.

The Special Commissioners in para. 10(8) concluded on the evidence that the main object of the creation and issue of the 1958 redeemable preference shares was to cure the unknown defect in the 1951 issue—to restore the status quo in that respect—and that this restoration, quite apart from the concurrent public flotation, afforded a bona fide commercial reason and that the obtaining of a tax advantage was not a main reason. So far as the redemption of the 1958 issue of preference shares is concerned, the Special Commissioners in their reasons (para. 10(9) of the Case) said that this was essentially the second half of an operation begun in 1958, replacing the 1951 issue. But for the projected flotation the 1951 issue would probably have been redeemed in 1958 or 1959: the deferment of redemption until 1963 was decided upon to facilitate

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A the public flotation—a bona fide commercial reason—and that the redemption itself “was carried out for bona fide commercial reasons, in order (as it was expressed in evidence) to implement the bargain made with the public in 1958.” They expressed themselves as satisfied that the obtaining of a tax advantage was not a main object of the 1963 redemption.

We turn to the judgment of Walton J. below. He dealt with the matter purely on the question of bona fide commercial reasons, understanding (mistakenly, we are told) that the taxpayer no longer relied alternatively on the ordinary course of management of investments (as to which there had been no finding by the Commissioners), and that the Crown no longer contended that a main object was the obtaining of a tax advantage. So far as the 1951 creation and issue of the assumed redeemable preference shares was concerned, Walton J. considered that the Special Commissioners erred in law in forming the view that when the sole object of that creation and issue was to preserve family control of the company and its business it was within the ambit of “bona fide commercial reasons”. He took the view that the reasons behind the creation and issue were properly to be labelled “financial” and not “commercial”. So far as the 1958 “restoration of the status quo” was concerned, Walton J. found no radical alteration from the reasons for the 1951 transaction: and in his view the 1963 redemption followed in due course, correctly saying that it was not done to implement any bargain with the public, though the postponement of redemption might have been based on commercial reasons as promoting a successful flotation.

Walton J. did not find much assistance from the cases cited to him. Nor do we. *Commissioners of Inland Revenue v. Brebner*⁽¹⁾ [1967] 2 A.C. 18 was a case in which there was ample reason for the view that if the steps were not taken the business of the company, in the continuation of which the actors were both directly and indirectly much interested, would come to an end: there is a passage in the opinion of Lord Upjohn which Walton J. perhaps took to indicate that the Special Commissioners would have been well entitled to take the view that such would *not* constitute commercial reasons: but in fact all that was said was that the Special Commissioners might have concluded (but did not) that there were two separate chapters in the transactions, the first for commercial reasons and the second with as its main object the obtaining of a tax advantage.

Bulmer v. Commissioners of Inland Revenue⁽²⁾ [1967] Ch. 145 was a case indicating that the expression “bona fide commercial transaction” was used judicially to describe something lacking an element of bounty, in determining whether there was a “settlement”. It does not we think help, though it indicates, as one would expect, that there can be a bona fide commercial transaction with the obtaining of a tax advantage as a main object.

Hague v. Commissioners of Inland Revenue⁽³⁾ [1969] 1 Ch. 393 was indeed such a case. It was assumed that the Special Commissioners found bona fide commercial reasons: but they also found a main object of obtaining a tax advantage, which finding the taxpayer failed to upset. On the “commercial” point, there was involved a reorganisation and rationalisation of the company’s cotton mills business, and a substantial proportion of the shareholders were pressing for a liquidation and distribution. What actually was done was a capitalisation of profits by the issue of bonus shares followed by reduction of capital by repayment out of assets surplus to the company’s needs.

(1) 43 T.C. 705. (2) 44 T.C. 1. (3) 44 T.C. 619.

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Commissioners of Inland Revenue v. Parker⁽¹⁾ [1966] A.C. 141 was a case in which accumulated profits were distributed in 1953 in the form of paid-up debentures, in order that on the death of a shareholder money might be made available to meet death duties, particularly as the shares of one holder might be valued on an assets basis. The debentures were redeemed in 1961. It was not contended by the taxpayer that there were involved any bona fide commercial reasons. The arguments were concerned with other matters. And we do not think that the lack of contention on the part of the taxpayer is really significant in the present case; the facts found there were different.

We agree that one should start with the 1951 transaction as part of the whole picture, and in considering the reasons for it the failure to achieve redeemability must of course be ignored. Basically, the motive or reason as found by the Special Commissioners was the retention of family control of the company and its business. Were the Special Commissioners guilty of misconstruction of the phrase "for bona fide commercial reasons" in the Statute in holding that such a reason could be commercial? Or was the conclusion such that no body of Commissioners properly instructed in the law could arrive at it? Walton J. considered the reason to be "financial" and therefore not "commercial", an approach which we do not find persuasive. It is not unknown for the prosperity of a business to depend in part on the very fact that it is an old-established family business and continues as such under family control and management, both in the context of company-customers relationships and of the employer-employees relationships. Had the Commissioners stated in terms that the reasons for hoping to retain family control were because of its value under those headings, we do not think that their finding that these were bona fide commercial reasons could possibly have been faulted. And we see no reason why they should be taken as having ignored in "family control" those considerations when concluding that there were bona fide commercial reasons behind the intended 1951 transaction.

Both the Commissioners and Walton J. in substance worked onwards through the transactions of 1958 and 1963 from their opposing standpoints as to 1951—that nothing in point of reasons was really changed. We consider that there were changes in the circumstances that, if anything, lent support to the presence in 1958 of bona fide commercial reasons. It is true that the threat to family control by the need to meet estate duty was much lessened by 1958: though, in considering motives of the actors, this aspect may not have been fully appreciated in the atmosphere of crisis. On the other hand, by the time the defect in the 1951 issue was discovered, plans for the public flotation were well under way, with a view in part, as the Commissioners found, to the advantage of the company and its business. As we have already indicated, the whole scheme for public flotation was, in the view of the Commissioners, at risk if the supposedly redeemable 1951 preference shares were not replaced, and, to the extent of the acquisition for £95,000 of 50 per cent. of the Akron shares, the scheme had already been carried out in April 1958, before the defect in the 1951 preference shares was discovered in June 1958. In all the circumstances, we are not prepared to disagree with the conclusion of the Commissioners that the transactions in 1958 in relation to redeemable preference shares were carried out for bona fide commercial reasons. So far as concerns the redemption in 1963, we have already indicated that this was not properly described as an implementation of the bargain made with the public in 1958. Rather was it a fulfilment of the expectation of the trustees and other shareholders upon the

(1) 43 T.C. 396.

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- A basis of which the scheme of public flotation went through. But the redemption as a transaction cannot in our view be regarded in isolation. As Walton J. said, the redemption was *in gremio* the 1958 issue of the shares, and had he taken the view that the 1958 transactions were carried out for bona fide commercial reasons, we have no doubt that he would have considered that label equally appropriate to the redemption in 1963. We so consider it.
- B As we have indicated, Walton J. did not deal with the question whether the transactions or any of them had as a main object to enable tax advantages to be obtained. The Commissioners answered the question in the negative. This is essentially a matter of subjective fact, and we are quite unable to accept the Crown's contention that this was a finding at which the Commissioners could not reasonably arrive.
- C In those circumstances, it is not necessary to arrive at a conclusion on the question whether the transactions or any of them were also carried out in the ordinary course of making or managing investments, supposing that such a finding is not inconsistent with the finding as to commercial reasons. Nor is it necessary to pronounce upon the secondary point in relation to the Goodwin shares: but it is right to say on this that we found ourselves sufficiently in agreement with Walton J.'s views thereon not to call upon the Crown to answer the taxpayer's contention.

D We add a general observation. The main points for decision in this case—the objects and reasons of and for the transactions in question—are pre-eminently questions of fact (and indeed of subjective fact) for determination by the Commissioners with expertise in this sort of field, and in the rarest case should a Court find itself able to disagree with them.

E We accordingly allow the appeals with such consequential Orders as will restore the Order of the Special Commissioners cancelling the notices in question.

Nolan Q.C.—Would your Lordships say that the appeal is allowed with costs?

Russell L.J.—Yes.

F Potter Q.C.—My Lord, I cannot resist that.

My Lord, may I make an application for leave to appeal to the House of Lords? Perhaps I might briefly say this. Although the escape clause is largely a matter of fact, your Lordships have made a finding of law to this extent, that the meaning of the word “commercial” is such that it could include retention of family control *per se*. Your Lordships will appreciate that that could have a very wide effect on cases that come before the tax authorities almost every day, where family control is to be retained by extracting money from a company. Therefore, I would submit it is a proper case for leave to be granted.

G Russell L.J.—Are you both prepared to accept the decision of two of us on this application?

Nolan Q.C.—My Lord, yes.

H Potter Q.C.—Yes.

(The Court conferred.)

Russell L.J.—No, Mr. Potter.

Potter Q.C.—If your Lordship pleases.

The Crown having been granted leave by the Appeal Committee of the House of Lords to appeal against the above decision, the case came before the House of Lords (Lords Diplock, Morris of Borth-y-Gest, Kilbrandon, Salmon and Edmund-Davies) on 17th, 18th, 19th and 20th November 1975, when judgment was reserved. On 28th January 1976 judgment was given unanimously against the Crown, with costs. A

D. C. Potter Q.C. and *Brian Davenport* for the Crown. B

Michael Nolan Q.C. and *Stephen Oliver* for the taxpayer.

The following cases were cited in argument in addition to those referred to in the speeches:—*Bulmer v. Commissioners of Inland Revenue* 44 T.C. 1; [1967] Ch. 145; *Green v. Commissioners of Inland Revenue*⁽¹⁾ (1972) T.C. Leaflet No. 2456 (Ch.D.); *Commissioners of Inland Revenue v. Parker* 43 T.C. 396; [1966] A.C. 141; *Saxone Lilley & Skinner (Holdings) Ltd. v. Commissioners of Inland Revenue* 44 T.C. 122; [1967] 1 W.L.R. 501; *Ransom v. Higgs* 50 T.C. 1; [1973] 1 W.L.R. 1180 (C.A.); [1974] 1 W.L.R. 1594 (H.L.). C

Lord Diplock—My Lords, I have had the advantage of reading in advance the speech to be delivered by my noble and learned friend, Lord Kilbrandon. I agree with him and would dismiss the appeal. D

Lord Morris of Borth-Y-Gest—My Lords, before the Special Commissioners it was for the Respondent to show that the transactions in question were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments and further that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained. As to this latter matter the Special Commissioners found that the obtaining of tax advantage was not a main object of any of the transactions. The point of difficulty in the case concerned the question whether in regard to the 1951 transaction (from which the later transactions stemmed and with which they were linked) the conclusion of the Special Commissioners that its object was a bona fide commercial one was a conclusion which ran counter to and was not warranted by their findings of fact. Was the evidence which was accepted inconsistent with and contradictory of their conclusion? Though a contention to this effect was very forcibly argued, and though during our consideration of the appeal I was impressed by the reasoning in the careful judgment of Walton J., I came in the end, though after hesitation, to the view that the reasoning of the Court of Appeal was to be preferred and for the reasons given by my noble and learned friend Lord Kilbrandon—whose speech I have had the advantage of reading in advance—I agree that the appeal should be dismissed. E

Lord Kilbrandon—My Lords, *R. Goodwin & Sons (Engineers) Ltd.* (“the company”) are incorporated for the purpose of carrying on an engineering business established in the Midlands in 1883. The founders were a Mr. Goodwin and his sons. When the incorporation into a private company took place in 1935, two of old Mr. Goodwin’s grandsons, Frank and John, were directors; in 1954 the board was joined by a great-grandson, who is the Respondent, and another director. Economic history testifies to the fact that such concerns have been the backbone of English manufacturing prosperity, and this fact may turn out to be important. F

The ensuing narrative is derived from the findings of fact made by the Special Commissioners in circumstances which will become apparent. The G

(1) To be published later in this volume. H

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A narrative is given in skeleton form, so as, so far as possible, to include only the facts which are essential to a decision of the appeal, because there is a full statement to be found in the judgment of the Court of Appeal, and there is no point in repetition. I may say straight away that I agree with the approach adopted by the Court of Appeal, and the conclusion at which the Court arrived.

B 1. In 1951 consideration was given to the company "going public", thus obtaining access to fresh capital for expansion purposes. But the time was deemed unpropitious because, *inter alia*, the recent dividend record had not been such as to make public support probable.

C 2. The shares at that time were held as to 40 per cent. by John Goodwin senior, then aged 55, and by trustees of family settlements made by him, 30 per cent. by Frank Goodwin, then aged 60, and by trustees of family settlements made by him, and 30 per cent. by the Respondent. The trust holdings had been constituted so recently as to make the shares aggregable for estate duty with the estates of the settlors on decease. To meet the duty it would probably have become necessary to sell shares, with the danger of family control being lost. The importance of family control will be adverted to later.

D 3. It was therefore decided, and the company resolved accordingly, to increase the capital of the company by capitalising £44,525 from profit and loss account, to create 6 per cent. preference shares redeemable by the company at three months' notice after twelve months, and to issue those shares to the existing shareholders as a five to one bonus issue. Thus, on redemption, resources would have become available to meet the threat to the family control. It is important to emphasise that the Special Commissioners find as a matter of fact that the decision referred to under heading 3 above was taken for the reasons given under heading 2, "that the main object of the 1951 preference share issue was a bona fide commercial one, and that the obtaining of a tax advantage was not a main object."

F 4. In 1958 it was decided that the history and prospects of the company were such as to make the time ripe for a public issue. The method by which this was to be effected was described by the Court of Appeal as follows⁽¹⁾:

G "After a good many varying suggestions, the scheme evolved for a public flotation was as follows, accepted by the Goodwin family and trustees of the settlements: (1) acquisition by the company of the outstanding 71 per cent. shareholding in a company ('Akron') so as to make it a 100 per cent. subsidiary; (2) the 1951 bonus issue of preference shares to be made irredeemable for a period of some five years to enable expanding trade to replace the substantial sum (some £130,000) of working capital required for the Akron acquisition; (3) half the ordinary shares in the company to be converted into deferred ordinary shares, the offer to the public to be made out of the unconverted ordinary shares; the deferred ordinary shares to remain as such until after the redemption of the 1951 preference shares."

H 5. At this stage a crisis arose; it was discovered that the preference shares had been issued pursuant to an ordinary, not a special, resolution of the company, and that therefore the essential quality of redeemability did not attach to them. The foundation of the scheme was thus insecure.

I 6. Although the danger of shares having to be sold to meet death duties was now less menacing, owing to the efflux of time having released the settled

(1) Page 605 *ante*; [1975] 1 W.L.R. 640.

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shares from liability to duty, it was still real. It was related now in part to the survivorship of the Respondent. Any action which was to be taken had accordingly still to be effective in the two respects of securing the family control and enabling the issue to the public. The obvious thing to do was, by the most convenient means, so to restructure the capital as to re-make the provision which it was thought had been made in 1951. Again to quote the judgment of the Court of Appeal⁽¹⁾:

"This was done, first, by converting the 1951 preference shares into deferred ordinary shares. The company then capitalised the sum of £171,095 from its general reserve and applied that sum in paying up at par: (a) 44,525 out of 45,000 newly-created £1 6 per cent. redeemable preference shares; (b) 81,095 of previously unissued (6,095) and newly-created (75,000) ordinary shares; (c) 45,475 of previously unissued (475) and newly-created (45,000) deferred ordinary shares, the 475 representing the converted unissued 1951 preference shares. The capital structure of the company for the purpose of the public flotation was thus: issued ordinary £90,000, of which a proportion (£54,000) was to be offered to the public: issued deferred ordinary shares, £90,000: issued 6 per cent. redeemable preference shares, £44,525: unissued redeemable preference shares, £475. The redeemable preference shares were redeemable at the company's option after 30th April 1963. The deferred ordinary shares were to rank *pari passu* as one class with the ordinary shares only after twelve months from the redemption of the preference shares."

7. As regards this scheme the Special Commissioners observe:

"We are satisfied on the evidence that the main object of the 1958 preference share issue was to restore the *status quo ante* in this respect. We think that the restoration in itself, and even without regard to the then current intention to embark upon a public flotation of shares in the company, affords a bona fide commercial reason for the 1958 issue of redeemable preference shares, and we find that the obtaining of a tax advantage was not a main object of the 1958 transaction."

In so far as this passage is a finding of fact, in my opinion the Special Commissioners were well entitled to make it and, so far as it is an inference from facts, I would say that the inference was justifiable if not irresistible.

8. On 19th August 1958 an offer was made to the public of 540,000 ordinary shares of 2s. each (that is, £54,000 shares of £1 each sub-divided). The particulars attached to the offer (signed by John Goodwin senior) contained the following paragraph:

"Management.—I am 62 years of age and have been actively engaged in the business since the end of the first World War. I have been Chairman of Directors and Managing Director of the Company since its incorporation in 1935. Mr. Frank Goodwin (my brother) is aged 67 and has spent all his working life with the business. He also has been a Director since the incorporation of the Company in 1935. Mr. John Goodwin (my son) is 31 years of age and joined the Company in August, 1946 becoming a Director in 1954. He is now Vice-Chairman and Assistant Managing Director. Mr. Henry Stubbs is aged 47 and has been with the business since June, 1927, becoming a Director in 1954. We are all actively engaged in the service of the Company and have no other business commitments. We have

⁽¹⁾ Pages 605-6 *ante*.

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A each entered into a service agreement with the Company for a minimum period of five years from 1st May 1958 (See Contracts numbered (3) to (6) inclusive below). The present management has been responsible for building up the business of the Group and I have every confidence in its ability to maintain continued progress."

B 9. On 30th April 1963, that is, at the earliest possible date, the company redeemed the preference shares for cash out of the capitalised reserves of the company. The Respondent's holding of 13,355 shares had been transferred by him on 18th August 1958 to his wife, to whom, accordingly, the redemption moneys were paid. The Special Commissioners found that the redemption was "in order to implement the bargain made with the public in 1958". This phrase was severely criticised by Counsel for the Crown, and for my part I agree that
C it is not accurate. Such of the public as should subscribe for shares had no interest in the issue or redemption of the preference shares, and no bargain had been made with the public relating to them. In my opinion the Court of Appeal correctly state the nature of the transaction as "a fulfilment of the expectation of the trustees and other shareholders upon the basis of which the scheme of public flotation went through." It was a *sine qua non* of the public issue.

D 10. On 5th May 1969 the Commissioners of Inland Revenue issued a notice to the Respondent under s. 28 of the Finance Act 1960, as amended by s. 25(4) of the Finance Act 1962, claiming to make adjustments to his liability to surtax for the year 1963-64 in respect of the following transactions:

E "1. the special resolution of R. Goodwin & Sons (Engineers) Ltd. (hereinafter called 'the company') on 18th August 1958 to capitalise the sum of £171,095, part of the company's general reserve, and, *inter alia*, to apply part of that sum to paying up in full 44,525 6 per cent. redeemable cumulative preference shares of £1 each, such shares, (a) to be distributed amongst the holders of the ordinary shares in the company in the proportions specified in the resolution and (b) to carry rights including the company's right, on giving due notice, to redeem them on or at any time
F after 30th April 1963;

2. the issue to you, on or about 18th August 1958, pursuant to the aforesaid special resolution, of 13,355 of the aforesaid redeemable preference shares and the transfer of those shares from you to your wife, Mrs. Patricia M. Goodwin, on or about 1st September 1958;

G 3. the receipt by your wife on or about 30th April 1963 of £13,355 by way of redemption of her holding of 13,355 of the aforesaid redeemable preference shares."

It is necessary at this stage to quote only a portion of s. 28, as follows:

H "(1) Where—(a) in any such circumstances as are mentioned in the next following subsection, and (b) in consequence of a transaction in securities or of the combined effect of two or more such transactions, a person is in a position to obtain, or has obtained, a tax advantage, then unless he shows that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained, this section shall apply to him in respect of that transaction or those transactions . . . (2) . . . (c) the person in question receives, in consequence of a transaction whereby any other person—(i) subsequently receives, or has
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received, an abnormal amount by way of dividend; or (ii) subsequently becomes entitled, or has become entitled, to a deduction as mentioned in paragraph (b) of this subsection, a consideration which either is, or represents the value of, assets which are (or apart from anything done by the company in question would have been) available for distribution by way of dividend, or is received in respect of future receipts of the company or is, or represents the value of, trading stock of the company, and the said person so receives the consideration that he does not pay or bear tax on it as income; or (d) in connection with the distribution of profits of a company to which this paragraph applies, the person in question so receives as is mentioned in paragraph (c) of this subsection such a consideration as is therein mentioned.”

The arrangements for counteracting tax advantages, and for the consequent procedures, follow but need not be quoted.

As affecting the Respondent personally, there is a special point arising out of the transfer by him to his wife. I will therefore summarise the situation arising on the section in this appeal as it affects the shareholder in general. First, it is conceded that the shareholder is a person who received, within the meaning of s. 28(2)(c) and (d), assets of the company which were or would have been available for distribution by way of dividend in such a way that he did not bear tax on them as income, and received them in consequence of a transaction or transactions in securities. He therefore obtained a tax advantage within the meaning of s. 28(1). The section will apply to him, that is to say, the Commissioners of Inland Revenue will be entitled to make an adjustment to his liability for surtax unless he can exempt himself in one of the ways set out in the section. It is further conceded that neither of the transactions referred to in the notice had as its main object to enable the tax advantage to be obtained. The questions therefore are, has he shown that the transactions were carried out either (a) for bona fide commercial reasons, or (b) in the ordinary course of making or managing investments? It is with (a) that this appeal is mainly concerned. Although only the 1958 and 1963 transactions figure in the notice, I believe it is generally agreed that those transactions, although they must be considered independently, cannot be evaluated for the purpose of (a) above, or even intelligibly described, save under colour of the transaction of 1951. The scene was set in 1951, and what followed, in the history of the company over the ensuing twelve years, was the working out of the policies which at that time satisfied the company as being in its best commercial interests. There is an unchallengeable finding of fact by the Special Commissioners that the 1951 transaction was carried out for bona fide commercial reasons. While the onus remains on the Respondent to show that the same is true of the subsequent transactions, it will, I apprehend, not be difficult to do that if the essentially homogeneous character of the successive transactions, and the “reasons” for them, can be established. This will be again largely a question of fact; one of the main difficulties I have found in this appeal is to discern a question of law, upon which alone your Lordships would be justified in overruling the decision of the Special Commissioners.

An overriding reason for the 1958 transaction—being, besides and apart from the motive of facilitating access to the public money-market, as true of 1958 as it was of 1951—was the retention of family control of the company. It was conceded in argument by Counsel for the Crown that, if the Special Commissioners had specifically and in so many words found that the loss of family control would have had deleterious commercial consequences to the

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- A company, that finding would have amounted to a finding that a transaction entered into for the purpose of protecting that control had been carried out for bona fide commercial reasons. There is no such explicit finding, but the whole tenor of the findings is to that effect, and the substance of the matter seems to be clear and indisputable when the management paragraph in the particulars, already quoted, is properly taken into account. The public, whose support was being solicited, were being invited to regard the continuity of family management as part of the invisible commercial assets of the company, and that appears to me to go the whole way to finding a commercial reason for the securing of that management.

- As regards the 1963 transaction, it was submitted by the Crown that, the only finding of fact justifying its classification as a bona fide commercial transaction, namely, that it was entered into "in order to implement the bargain made with the public in 1958", having been shown to be erroneous, there were no facts upon which the Special Commissioners were entitled to arrive at their conclusion. My Lords, I have already pointed out that, as the Court of Appeal decided, this a verbal rather than a substantial criticism. What was implemented in 1963 was an agreement between the company and the shareholders, some of whom were under a fiduciary duty to protect rights under settlements, as to the terms upon which the issue of ordinary shares was to be made to the public. The transaction, which the Special Commissioners found did not have as a main object the obtaining of a tax advantage, was entered into as the final stage in the attainment of bona fide commercial objects, namely, access to the money-market coupled with continuance of family management, with the advantages to the company to which I have referred.

It was also submitted for the Respondent that the transactions escaped the consequences which ensue under s. 28 on the grounds that they were carried out "in the ordinary course of making or managing investments". It is not necessary to express any opinion on that, and I refrain from doing so.

- The special position of the Respondent is that he had transferred his shares to his wife after allotment and before redemption. On the terms of s. 28, accordingly, he could have claimed that not he, but his wife, had received the consideration referred to in s. 28(2)(c)—see *Hague v. Commissioners of Inland Revenue*⁽¹⁾ [1969] 1 Ch. 393—and that thus he had obtained no tax advantage. The Legislature sought to alter this situation by s. 25(4) of the Finance Act 1962 which provides that in such circumstances s. 28 applies to a husband "as it would apply if any property, rights or liabilities of the wife were his property, rights or liabilities in relation to which she had acted only as nominee for him". I am bound to say, my Lords, that it appears to me that that amendment covers the present case but, since it is not necessary to decide the point, I would not do so.

- My Lords, since in my opinion the findings of fact of the Special Commissioners amount to this, that the transactions referred to in the notice were carried out for bona fide commercial reasons and that neither of them had as a main object to enable a tax advantage to be obtained, I would dismiss this appeal.

Lord Salmon—My Lords, I have had the advantage of reading the speech prepared by my noble and learned friend, Lord Kilbrandon. For the reasons given by him, I would dismiss this appeal.

(1) 44 T.C. 619.

Lord Edmund-Davies—My Lords, I cannot help thinking that the Special Commissioners might well have arrived at different findings of fact on the material available to them in this case than those they in fact made, and that had they done so those different findings would have been unassailable. I am, nevertheless, in agreement that, for the reasons appearing in the speech of my noble and learned friend, Lord Kilbrandon, this appeal should be dismissed. Why this should be so was explained in *Edwards v. Birstow*(¹) [1956] A.C. 14 by Lord Radcliffe, who said, at page 38:

“ . . . the reason why the courts do not interfere with commissioners’ findings or determinations when they really do involve nothing but questions of fact is not any supposed advantage in the commissioners of greater experience in matters of business or any other matters. The reason is simply that by the system that has been set up the commissioners are the first tribunal to try an appeal, and in the interests of the efficient administration of justice their decisions can only be upset on appeal if they have been positively wrong in law. The court is not a second opinion, where there is reasonable ground for the first. . . . Their duty is no more than to examine those facts with a decent respect for the tribunal appealed from and if they think that the only reasonable conclusion on the facts found is inconsistent with the determination come to, to say so without more ado.”

Looming over all the details of this case is the crucial question: Was the obtaining of a tax advantage the main object, or one of the main objects, of the transactions of 1951, 1958 and 1963, or any of them, to which the Respondent was a party? As Russell L.J. said in the Court of Appeal [1975] 1 W.L.R. 640, at page 648G(2): “This is essentially a matter of subjective fact” and the conclusion thereon depended on the evidence, both oral and documentary, which was adduced. There are certain features of that evidence which leave me personally unconvinced that I should have arrived at the same findings of fact, subjective as well as objective, as those formed by the Special Commissioners. But that is not the test. Accordingly, while I am not prepared to hold that there was here that “ample evidence” which in, for example, *Commissioners of Inland Revenue v. Brebner*(³) [1967] 2 A.C. 18 led this House to refuse to interfere with the finding of fact upon which the Special Commissioners there arrived, yet since, at the same time, I find it impossible to say that the only reasonable conclusion on the facts found is inconsistent with the determination come to in the instant case, I concur in holding that the appeal should be dismissed.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and the appeal dismissed with costs.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Waltons & Co., for Pinsent & Co., Birmingham.]

(1) 36 T.C. 207, at p. 231.

(2) Page 609 ante.

(3) 43 T.C. 705.