
HOUSE OF LORDS—5 NOVEMBER
AND 3 DECEMBER 1981

Commissioners of Inland Revenue v. Burmah Oil Co. Ltd.⁽¹⁾

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Corporation tax—Chargeable gains—Allowable losses—Tax avoidance scheme involving disposal of shares by parent company following rights issue by subsidiary company—Consideration for rights issue—Whether market value or issue price—Finance Act 1965, s 22(4), Sch 7, para 4—Whether loss to which scheme gave rise to be disregarded.

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The Respondent Company (“Burmah”) was the parent company of a group of companies of which Holdings was a member. At all material times Burmah was the beneficial owner of the entire issued share capital of Holdings. In 1969 Burmah sold to Holdings £50,000,000 stock in The British Petroleum Co. Ltd. (“BP”) for £380,625,000, the purchase price being left outstanding. In 1971 Holdings sold the BP stock to Burmah for £220,625,000. Thereafter Holdings, which had no other assets, owed Burmah £159,299,999. To produce an allowable capital loss for corporation tax purposes a pre-arranged scheme was subsequently entered into between Burmah, Holdings and another subsidiary company of Burmah (“MORH”). On 12 December 1972 MORH borrowed £159,299,999 from Burmah and lent that amount to Holdings, which in turn repaid Burmah. On 18 December 1972 Holdings made a rights issue for a total consideration paid by Burmah directly or through its nominee of £159,600,228; on the same day Holdings repaid £159,299,999 to MORH and MORH repaid that amount to Burmah. Holdings then went into liquidation.

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On appeal to the Special Commissioners Burmah claimed that it had incurred an allowable capital loss on the disposal, by liquidation, of its shares in Holdings and in addition to the cost of acquiring its original shares in Holdings was entitled to deduct the sum of £159,600,228 paid for the additional shares. Burmah contended that para 4(2) and (3) of Sch 7, Finance Act 1965, applied to the rights issue and that, in computing its loss on disposal, the cash paid for the new shares therefore fell to be treated as having been given as consideration for the original shares. The Crown contended that (i) the joint legal effect of the transactions comprised in the pre-arranged scheme was the only legal effect of the transactions; (ii) the true consideration for the additional shares was the waiver of a valueless loan; (iii) there had been no reorganisation within the meaning of para 4(1) of Sch 7, Finance Act 1965; (iv) the additional shares were, in any event, not allotted to Burmah in respect of its holding of shares in Holdings, and (v) alternatively, the consideration given “wholly and exclusively for the acquisition of” the additional shares was to be treated as nil. The Special Commissioners allowed the appeal, holding that para 4(2) and (3) of Sch 7 applied and that the cash subscribed for the additional shares was consideration given “wholly and exclusively” for their acquisition. The Crown appealed.

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(1) Reported (CS) [1980] STC 731; (HL) [1982] STC 30; 1982 SLT 348.

A Before the Court of Session the Crown accepted that there had been a reorganisation of Holdings' share capital but submitted that, reading para 4(2) and (3) of Sch 7 with s 22(4), the consideration deductible on the disposal of the shares was, in respect of those obtained under the rights issue, not the cash paid but their market value at the time of the reorganisation.

B The Court of Session, unanimously dismissing the Crown's appeal, held that the Special Commissioners were entitled to hold that the cash paid for the additional shares fell to be treated as having been given as consideration for the original shares.

C In the House of Lords the Crown also contended, with leave, that the House of Lords decision in *W. T. Ramsay Ltd. v. Commissioners of Inland Revenue* 54 TC 101; [1981] 2 WLR 449 applied, so that the loss must be disregarded, except to the extent that a loss would have been realised in the liquidation in respect of the original shares if the scheme (apart from the liquidation) had not been carried out.

Held, in the House of Lords, unanimously allowing the Crown's appeal, (1) the Court of Session had rightly held that the new issue was made as part of a reorganisation of Holdings' capital within Sch 7, para 4(1) of the Finance Act 1965, so that the allotment of the new shares was, by para 4(2), not to be treated as an acquisition of those shares. There had therefore been no "acquisition . . . otherwise than . . . at arm's length" within s 22(4); so market value could not, by virtue of that subsection, be substituted for their issue price; but (2) *W. T. Ramsay Ltd. v. Commissioners of Inland Revenue* 54 TC 101 marked a significant change in the approach of the House of Lords to pre-ordained series of transactions, *whether or not they included the achievement of a legitimate commercial end*, into which steps with no purpose but tax avoidance were inserted; and (3) the principles therein stated applied to Burmah's scheme; so the increase in its loss was not allowable for purposes of capital gains tax, because it was not a "real" loss.

F CASE

Stated for the opinion of the Court of Session as the Court of Exchequer in Scotland under the Taxes Management Act 1970, s 56.

G I. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 25 October 1978 the Burmah Oil Co. Ltd. ("Burmah") appealed against an assessment to corporation tax for its accounting period ended 31 December 1972 in the sum of £3,278,700.

II. Shortly stated the question for our decision was whether on the disposal (on liquidation) of its shareholding in one of its wholly-owned subsidiary companies there accrued to Burmah for corporation tax purposes an allowable capital loss within the meaning of s 23, Finance Act 1965.

III. Mr. William Ramage Gage gave evidence before us.

H IV. Two bundles of documents were proved or admitted before us: they are available for inspection by the Court if required.

V. We have set out in our decision (para VII below) the facts which we find admitted or proved together with a summary of the contentions of the parties.

VI. During argument the following cases were referred to: *Salomon v. Salomon & Co., Ltd.* [1897] AC 22; *Duke of Westminster v. Commissioners of Inland Revenue* 19 TC 490; [1936] AC 1; *F. A. & A. B. Ltd. v. Lupton* 43 TC 86; [1965] Ch 390; *Finsbury Securities Ltd. v. Bishop* 43 TC 591; [1966] 1 WLR 1402; *Black Nominees Ltd. v. Nicol* 50 TC 229; *Harrison v. Nairn Williamson Ltd.* 51 TC 135; [1978] 1 WLR 145; *Eilbeck v. Rawling* 54 TC 101; [1982] AC 300.

VIII. We, the Commissioners who heard the appeal, gave our decision in writing on 3 January 1979 as follows:

1. Put shortly, the question before us is whether on the disposal (on liquidation) of its shareholding in OMDR Holdings Ltd. ("Holdings"), one of its wholly-owned subsidiary companies, there accrued to the appellant company ("Burmah") for corporation tax purposes an allowable capital loss within the meaning of s 23, Finance Act 1965. The background to the matter is broadly as follows. Assets which Burmah, in order to obtain a fiscal advantage, had sold to Holdings, leaving the purchase money outstanding on loan account, had declined in value with the result that Burmah had suffered a commercial loss by the reduction in value of the debt owing to it by Holdings. This debt was not a "debt on a security" and by reason of para 11, Sch 7, and s 23(1), Finance Act 1965, no allowable loss would have accrued to Burmah on its disposal. Burmah therefore took advice on how it might arrange its affairs so as to obtain tax relief for the commercial loss equivalent to the relief that it could have obtained if its investment in Holdings had been in the form of shares or debentures instead of an unsecured debt. Burmah followed the advice which it received and we have to decide whether the steps taken achieve its object.

2. Mr. W. R. Gage gave evidence before us. Mr. Gage was finance director of Burmah from July 1968 until his retirement in 1975. In December 1972 he was also a director of the following companies: Holdings, Manchester Oil Refinery Holdings Ltd. ("MORH"), Burmah Oil Trading Ltd. ("BOTL"). Mr. Gage was concerned in all the events described in para 3(1) to (7) below.

3. We find the following facts admitted or proved:

(1) Burmah is the parent company of a group of companies that at all material times included Holdings (formerly called at various times the BOC British Petroleum Share Trust Ltd., Burmah Investments Ltd. and Burmah Holdings Ltd.), MORH and BOTL. At all material times until the liquidation of Holdings Burmah was the beneficial owner of the entire issued share capital of that company. Prior to 1969 the capital consisted of 700,000 ordinary shares and one voting share, but on 6 March 1969 the voting share was converted into an ordinary share.

(2) Both on 6 April 1965 and immediately prior to the events described in sub-para (3) below, Holdings was dormant and its issued share capital was represented by a debt of £700,001 owing to it by Burmah.

(3) On 6 March 1969 Burmah sold and transferred to Holdings (then called the BOC British Petroleum Share Trust Ltd.) £50,000,000 stock in The British Petroleum Co. Ltd. ("BP") for £380,625,000. The reason for the sale was to enable Burmah (by using Holdings as a regulatory company, storing up dividends received from BP) to limit its receipt of dividends and thereby to limit its own dividend payments and at the same time to obtain maximum overspill relief under s 84, Finance Act 1965. The purchase price was left outstanding as a result of which the net amount owed by Holdings to Burmah of £379,924,999, (namely £380,625,000 less £700,001) was placed to a loan

A account ("the loan account") in Holdings' books. On 23 April 1971 the £50,000,000 stock in BP was sold and transferred by Holdings (then called Burmah Investments Ltd.) to Burmah for £220,625,000, reducing the balance outstanding on the loan account to £159,299,999. By this time overspill relief was no longer a problem and the sale was for good commercial reasons. Also in 1971 Burmah explored with counsel the possibility of obtaining for corporation tax purposes an allowable capital loss by the exploitation of the situation which had thus arisen. The events described in sub-paras (5) to (10) consisted of a pre-arranged scheme (approved by a meeting of Burmah's directors held on 20 July 1972) designed to achieve that end. At the material times there was to a very great extent a common membership between the boards of Burmah, Holdings, MORH and BOTL.

C (4) On 12 December 1972 700,000 shares in Holdings (then called OMDR Holdings Ltd.) were registered in the name of and beneficially owned by Burmah and one was registered in the name of BOTL as nominee for Burmah, its beneficial owner. Holdings never traded and the purchase and sale described in sub-para (3) above were the only functions it ever carried out.

D (5) On Tuesday, 12 December 1972, the following events took place in the following order (the timetable, draft minutes and draft letters having been prepared in advance):

(i) The directors of Holdings resolved to obtain loan facilities from MORH and, upon such facilities becoming available, to repay to Burmah the balance on the loan account of £159,299,999.

E (ii) Holdings applied to MORH for a loan facility of this amount repayable on demand.

(iii) On receipt of such application the directors of MORH authorised their chairman to arrange a loan of the amount in question from Burmah in order to enable the loan facility requested to be granted to Holdings. Application was duly made by MORH to Burmah for such a loan which was made, pursuant to a resolution of the directors of Burmah.

F (iv) The directors of MORH resolved that the loan facility requested by Holdings be granted and the sum of £159,299,999 was duly advanced by MORH to Holdings, repayable on demand.

(v) Upon this loan being made available, the said balance of £159,299,999 owing to Burmah on the loan account was repaid, pursuant to a resolution of the directors of Holdings.

G (6) On Monday, 18 December 1972, the following events took place in the following order (the timetable, draft minutes and draft letters having been prepared in advance):

H (i) The directors of Holdings resolved to convene an extraordinary general meeting for the purpose of considering a resolution to increase the capital of Holdings from £700,001 to £1,400,002 by the creation of an additional 700,001 ordinary shares of £1 each.

(ii) An extraordinary general meeting of Holdings was duly convened and held at which a resolution to effect such an increase of capital was passed as an ordinary resolution.

I (iii) The directors of Holdings resolved that Holdings make a rights issue to the existing members of 700,001 unissued ordinary shares of £1 each at a price of £228 per share.

(iv) Such shares were offered to the existing members of Holdings in proportion to their existing holdings (namely one for one). A

(v) Pursuant to a resolution of the directors of Burmah an application was submitted to Holdings in respect of 700,000 shares accompanied by payment of the subscription price. Pursuant to a resolution of the directors of BOTL an application was submitted to Holdings in respect of one share accompanied by payment of the subscription price. The directors of Holdings resolved to accept such applications and accordingly 700,000 new ordinary shares were issued to Burmah and one new ordinary share to BOTL. As consideration for the 700,000 new shares allotted to Burmah, Burmah paid to Holdings £159,600,000 and, as consideration for the new share allotted to BOTL, Burmah through its nominee paid to Holdings £228. B

(vi) Pursuant to a resolution of the directors of Holdings the loan of £159,299,999 from MORH was repaid. C

(7) On 19 December 1972 the directors of Holdings resolved that a declaration of solvency be sworn by a majority of the directors and lodged with the Registrar of Companies and that an extraordinary general meeting of Holdings be convened for the purpose of considering a resolution for winding up Holdings. On that date the declaration of solvency was duly sworn, notice of an extraordinary general meeting to be held on 21 December 1972 circulated, and the members of Holdings consented to the said meeting being held at short notice. D

(8) At an extraordinary general meeting of Holdings duly convened and held on 21 December 1972 a special resolution that Holdings be wound up voluntarily as a members' voluntary winding-up and that Thomas Norman Ritchie be appointed liquidator and an extraordinary resolution that the liquidator be authorised to divide among the members in specie all or part of the assets of Holdings were passed. E

(9) The winding-up of Holdings was conducted by the liquidator and in the course of such winding-up the only asset of Holdings, namely, cash in the sum of £296,728.50, was distributed to its members on 29 December 1972. Holdings was subsequently dissolved. F

(10) On 24 September 1974 Burmah elected, pursuant to the provisions of para 25(1), Sch 6, Finance Act 1965, that the chargeable gains in relation to the disposal of the shareholding in Holdings in the beneficial ownership of Burmah be calculated by reference to the market value of the holding on 6 April 1965.

(11) The calendar year 1972 constituted an accounting period of Burmah for the purposes of corporation tax. Apart from the facts hereinbefore set out, Burmah had net chargeable gains in that period amounting to £3,397,724. G

4. It was common ground between the parties that the transactions with which these proceedings are concerned were carried out correctly as planned and were genuine transactions.

5. In the following paragraphs references to sections and Schedules are references to sections and Schedules of the Finance Act 1965. H

6. It was contended on behalf of Burmah by Mr. D. C. Potter Q.C. that:—

(i) the transactions described in para 3(6) above constituted a reorganisation of Holdings' share capital within the meaning of the first two lines of para 4(1), Sch 7; or, alternatively,

- A (ii) new shares in Holdings were issued to Burmah and BOTL "in respect of and in proportion to . . . their holdings of shares in" Holdings and constituted a reorganisation of Holdings' share capital by virtue of para 4(1)(a)(i);
- (iii) in either case, sub-paras (2) and (3) of para 4, Sch 7, apply;
- (iv) accordingly, by virtue of para 4(2), Sch 7, such reorganization was to be treated as involving no disposition and no acquisition of shares in Holdings;
- B (v) by virtue of para 4(3), Sch 7, the cash paid by Burmah and BOTL for the new shares in Holdings falls to be treated as having been given as consideration for the original shares;
- (vi) such consideration is deductible in computing an allowable loss on the disposal of Burmah's entire shareholding in Holdings either: (a) on the grounds that, under s 22(9), provisions in Sch 7 override the "wholly and exclusively" test in para 4(1)(a), Sch 6 or (b) as having been given wholly and exclusively for the acquisition of shares, and
- C (vii) in computing the chargeable gain or loss arising to Burmah on the disposal (by liquidation) of its and BOTL's shares in Holdings, Burmah is entitled to deduct in addition to the costs of acquiring its original shares the sum of £159,600,228 paid for the new shares. Mr. Potter also formally submitted that *Harrison v. Nairn Williamson Ltd.* [1978] 1 WLR 145 and 51 TC 135 was wrongly decided so that, even if there were in the present case no reorganization under para 4, Sch 7, the actual cost of the new shares in Holdings was deductible in computing Burmah's allowable loss—s 22(4) having no application.
7. It was contended by Mr. E. O. Jackson on behalf of the Inland Revenue
- E that:
- (i) everything that happened must be construed in its context—a series of pre-planned transactions for the exclusive advantage of Burmah, carried out by its wholly-owned subsidiaries either as nominees or as agents and as "fettered" as were the transactions in *Black Nominees Ltd. v. Nicol* 50 TC 229, so that their joint legal effect was the only legal effect;
- F (ii) the circular cash payments between Burmah and its subsidiaries effected nothing. The true consideration given by Burmah for the allotted 700,001 shares in Holdings was the waiver of a valueless loan;
- (iii) properly construed, there had been no reorganization of Holdings' share capital within the meaning of the first two lines of para 4(1), Sch 7: there was merely a wholly artificial device (remote from any reorganization) to
- G secure a tax advantage;
- (iv) properly construed, Burmah and BOTL were allotted new shares in Holdings not "in respect of . . . their holdings of shares in the company" but in respect of and calculated by reference to the size of the worthless loan which OMDR owed to Burmah;
- (v) the effect of s 22(9) was not that Sch 7 overrode para 4 of Sch 6 but
- H that the Schedules must be read together and each may in appropriate circumstances apply;
- (vi) even assuming that he was wrong in his contention (ii) above, the consideration given by Burmah "wholly and exclusively for the acquisition of the asset" (within the meaning of para 4(1)(a), Sch 6) was, on the authority of Slade J.'s decision in *Eilbeck v. Rawling*⁽¹⁾ of July 1978, nil. Burmah did not
- I want more shares in its insolvent subsidiary: it simply wanted its loss on the money lent to it transmogrified into an allowable loss, and

(1) Page 140 ante.

(vii) in computing the chargeable gain or loss arising to Burmah on the disposal (by liquidation) of its and BOTL's shares in Holdings, Burmah is not entitled to deduct the sum which it paid for the new shares. A

8.(1) We have considered the carefully reasoned submissions of Mr. Potter and Mr. Jackson. We find that the relevant transactions were pre-planned and would, having regard to Burmah's status as parent of Holdings, MORH and BOTL and the composition of the boards of directors of those companies, have almost inevitably been carried out precisely according to plan. We do not accept, however, that the roles played by Burmah's subsidiaries were those of nominees or agents. Although directors of the subsidiaries, in their capacity as Burmah's directors, approved the scheme and in their capacity as directors of the subsidiaries endorsed it for Burmah's benefit, we feel unable to disregard the effect of the individual transactions which comprised the scheme as a whole. We think that this approach is consistent with authority. For example, Slade J., when faced with a somewhat similar problem in *Eilbeck v. Rawling*⁽¹⁾, rejected the Crown's contentions that a series of transactions designed to create an artificial allowable loss should be regarded as part of a single transaction and that payments which, as part of the scheme, passed in a circle, were ineffective because at the end of the day nothing in truth passed from anyone to anyone. B C D

(2) By parity of reasoning we accept Mr. Potter's contention that what took place was a reorganization of Holding's share capital within the meaning of the first two lines of para 4(1), Sch 7. What was done—an allotment to existing shareholders in return for cash of one share in Holdings for each share they already held—appears to us, in the ordinary meaning of the word, to be a reorganization of capital. We do not think that this is any the less so because the word “reorganization” in those first two lines (but not, be it noted, in the preceding cross-heading) is associated with “reduction”. Viewed commercially and leaving aside fiscal motives, it may seem to be a nonsensical transaction but whether as commercial sense or commercial nonsense it appears to us to be a “reorganization”. E

(3) We consider whether (if we are wrong in our view that it was a reorganization in the ordinary sense of the word) it comes within the extended meaning of the word given in para 4(1)(a), Sch 7. It being common ground that the new shares were allotted to Burmah and BOTL “in proportion to . . . their holdings”, this question depends only on whether the allotment to the shareholders was “in respect of” their previous holdings. The offer to existing shareholders was, in the very nature of the scheme, made to and accepted by them in their capacity as shareholders and we would say therefore that the consequent allotment had “reference to” or “regard or relation to” or “connexion with” (all phrases used in the Shorter Oxford English Dictionary to exemplify the use of the word “respect” in a context such as the present). In our view there was a reorganization within the meaning of para 4(1)(a). F G

(4) On this basis, sub-paras (2) and (3) of para 4, Sch 7, apply with the effect, first, that the reorganization is to be treated as involving no disposition and no acquisition of shares in Holdings and, second, that the cash paid for the new shares in Holdings falls to be treated as having been given as consideration for the original shares. We come then to consider how such consideration is to be treated in computing any chargeable gain or allowable loss on the disposal of Burmah's entire shareholding in Holdings. As we interpret s 22(9), it requires chargeable gains (and therefore allowable losses) on the disposal of assets to be computed under Sch 6 with such modifications as Schs 7 and 8 may require. H I

(1) Page 101 *ante*.

- A We would find it surprising if the intention of sub-paras (2) and (3) of para 4, Sch 7, in requiring certain things to be treated otherwise than they in reality be, was to make consideration that is in reality given for new shares allotted on a re-organization deductible in the computation irrespective of whether it is, within the meaning of para 4(1), Sch 6, given "wholly and exclusively for the acquisition of the asset". In applying para 4(1), Sch 6, we think that references to the
- B "asset" disposed of must be taken to be references to the new holding (including by definition the original shares) and that references to "the consideration" must be taken to be references to the total of the consideration actually given for the original shares and the consideration actually given for the new shares. We see no reason why the "wholly and exclusively" test should not apply to each element in the total by reference to the actual facts and we so hold.
- C (5) Mr. Potter contends in the alternative, however, that the consideration actually given for the newly allotted shares (which we have held to be the cash subscribed) was indeed given "wholly and exclusively" for their acquisition. It is common ground between the parties that the test to be applied here is objective and not subjective. In *Rawlings'* case⁽¹⁾, Slade J. held that a sum of money which was paid on the taxpayer's behalf for the purchase of a reversionary
- D interest was also paid in part for the fulfilment by a third party of its contractual obligation to procure the implementation of an "off-the-peg" tax avoidance scheme intended for the taxpayer's benefit. The situation there was thus different from that in *Burmah's* case. When we ask what did *Burmah* pay for other than shares we find nothing in the way of assets or rights such as those there were in *Rawlings'* case in addition to the reversionary interest. It is
- E true that *Burmah's* motive in procuring the allotment to itself and BOTL of shares was, as Mr. Jackson says, to transmogrify a bad debt into an allowable loss. But in our view that, taken alone, is irrelevant. We therefore accept Mr. Potter's contention in this respect.

9. The appeal succeeds in principle and we determine it as follows: the corporation tax assessment on *Burmah* for the accounting period ended 31
- F December 1972 is increased to £3,776,493 after allowing group relief (BOTL) of £1,989,361 with an allowable capital loss carried forward at 31 December 1972 of £156,605,777.

- VIII. The Appellants, immediately after the determination of the appeal, declared to us their dissatisfaction therewith as being erroneous in point of law and on 15 January 1979 required us to state a Case for the opinion of the Court
- G of Session as the Court of Exchequer in Scotland which Case we have stated and do sign accordingly.

IX. The question of law for the opinion of the Court is whether our decision was correct.

J. G. Lewis { Commissioners for the Special Purposes
E. Wix { of the Income Tax Acts

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18 September 1979

(1) Page 140 *ante*.

The case was heard in the First Division of the Court of Session (the Lord President (Emslie) and Lords Cameron and Stott) on 30 and 31 October 1980 when judgment was reserved. On 13 November 1980, judgment was given against the Crown, with expenses. A

The Lord Advocate (Lord Mackay of Clashfern Q.C.) and A. C. Hamilton for the Crown.

W. D. Prosser Q.C. and J. E. Drummond Young for the Company. B

No cases were cited in argument.

The Lord President (Emslie) [for the Court—The Lord President (Emslie), Lords Cameron and Stott]—There was, in the accounting period which ended on 31 December 1972, a disposal by the Respondents, the taxpayer company, of its shareholding in a wholly owned subsidiary company, OMDR Holdings Ltd. when Holdings went into liquidation. The taxpayer company claimed that in consequence of that disposal there accrued to them, for corporation tax purposes, an allowable capital loss within the meaning of s 23 of the Finance Act 1965. This was the claim which formed the subject-matter of their appeal to the Special Commissioners against an assessment to corporation tax which had been made upon them for the accounting period in question. In the result the Special Commissioners upheld the appeal and the Commissioners of Inland Revenue have now appealed against that decision to this Court. C
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In order to focus the point taken by the Crown before us it is, we think, necessary to set out in some detail the history of the events which led to the making of the taxpayer Company's claim. It has been admirably explained by the Special Commissioners in findings which cannot readily be compressed and we begin with their general description of the background against which the findings in fact fall to be read. It is as follows: E

“Assets which Burmah, in order to obtain a fiscal advantage, had sold to Holdings, leaving the purchase money outstanding on loan account, had declined in value with the result that Burmah had suffered a commercial loss by the reduction in value of the debt owing to it by Holdings. This debt was not a ‘debt on a security’ and by reason of para 11, Sch 7, and s 23(1), Finance Act 1965, no allowable loss would have accrued to Burmah on its disposal. Burmah therefore took advice on how it might arrange its affairs so as to obtain tax relief for the commercial loss equivalent to the relief that it could have obtained if its investment in Holdings had been in the form of shares or debentures instead of an unsecured debt. Burmah followed the advice which it received and we have to decide whether the steps taken achieve its object.” F
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The findings in fact are in these terms:

“(1) Burmah is the parent company of a group of companies that at all material times included Holdings (formerly called at various times the BOC British Petroleum Share Trust Ltd., Burmah Investments Ltd. and Burmah Holdings Ltd.), MORH and BOTL. At all material times until the liquidation of Holdings Burmah was the beneficial owner of the entire issued share capital of that company. Prior to 1969 the capital consisted of 700,000 ordinary shares and one voting share, but on 6 March 1969 the voting share was converted into an ordinary share. H

(The Lord President (Emslie))

A (2) Both on 6 April 1965 and immediately prior to the events described in (3) below, Holdings was dormant and its issued share capital was represented by a debt of £700,000 owing to it by Burmah.

B (3) On 6 March 1969 Burmah sold and transferred to Holdings (then called the BOC British Petroleum Share Trust Ltd.) £50,000,000 stock in The British Petroleum Co. Ltd. ('BP') for £380,625,000. The reason for the sale was to enable Burmah (by using Holdings as a regulatory company, storing up dividends received from BP) to limit its receipt of dividends and thereby to limit its own dividend payments and at the same time to obtain maximum overspill relief under s 84, Finance Act 1965. The purchase price was left outstanding as a result of which the net amount owed by Holdings to Burmah of £379,924,999 (namely £380,625,000 less £700,001) was placed to a loan account ('the Loan Account') in Holdings' books. On 23 April 1971 the £50,000,000 stock in BP was sold and transferred by Holdings (then called Burmah Investments Ltd.) to Burmah for £220,625,000, reducing the balance outstanding on the loan account to £159,299,999. By this time overspill relief was no longer a problem and the sale was for good commercial reasons. Also in 1971 Burmah explored with counsel the possibility of obtaining for corporation tax purposes an allowable capital loss by the exploitation of the situation which had thus arisen. The events described in sub-paras (5) to (10) consisted of a pre-arranged scheme (approved by a meeting of Burmah's directors held on 20 July 1972) designed to achieve that end. At the material times there was to a very great extent a common membership between the boards of Burmah, Holdings, MORH and BOTL.

E (4) On 12 December 1972 700,000 shares in Holdings (then called OMDR Holdings Ltd.) were registered in the name of and beneficially owned by Burmah and one was registered in the name of BOTL as nominee for Burmah, its beneficial owner. Holdings never traded and the purchase and sale described in sub-para (3) above were the only functions it ever carried out.

F (5) On Tuesday, 12 December 1972, the following events took place in the following order (the timetable, draft minutes and draft letters having been prepared in advance): (i) The directors of Holdings resolved to obtain loan facilities from MORH and, upon such facilities becoming available, to repay to Burmah the balance on the loan account of £159,299,999. (ii) Holdings applied to MORH for a loan facility of this amount repayable on demand. (iii) On receipt of such application the directors of MORH authorised their chairman to arrange a loan of the amount in question from Burmah in order to enable the loan facility requested to be granted to Holdings. Application was duly made by MORH to Burmah for such a loan which was made, pursuant to a resolution of the directors of Burmah. (iv) The directors of MORH resolved that the loan facility requested by Holdings be granted and the sum of £159,299,999 was duly advanced by MORH to Holdings, repayable on demand. (v) Upon this loan being made available, the said balance of £159,299,999 owing to Burmah on the loan account was repaid, pursuant to a resolution of the directors of Holdings.

H (6) On Monday, 18 December 1972, the following events took place in the following order (the timetable, draft minutes and draft letters having been prepared in advance): (i) The directors of Holdings resolved to

(The Lord President (Emslie))

convene an extraordinary general meeting for the purpose of considering a resolution to increase the capital of Holdings from £700,001 to £1,400,002 by the creation of an additional 700,001 ordinary shares of £1 each. (ii) An extraordinary general meeting of Holdings was duly convened and held at which a resolution to effect such an increase of capital was passed as an ordinary resolution. (iii) The directors of Holdings resolved that Holdings make a rights issue to the existing members of 700,001 unissued ordinary shares of £1 each at a price of £228 per share. (iv) Such shares were offered to the existing members of Holdings in proportion to their existing holdings (namely one for one). (v) Pursuant to a resolution of the directors of Burmah an application was submitted to Holdings in respect of 700,000 shares accompanied by payment of the subscription price. Pursuant to a resolution of the directors of BOTL an application was submitted to Holdings in respect of one share accompanied by payment of the subscription price. The directors of Holdings resolved to accept such applications and accordingly 700,000 new ordinary shares were issued to Burmah and one new ordinary share to BOTL. As consideration for the 700,000 new shares allotted to Burmah, Burmah paid to Holdings £159,600,000 and, as consideration for the new share allotted to BOTL, Burmah through its nominee paid to Holdings £228. (vi) Pursuant to a resolution of the directors of Holdings the loan of £159,299,999 from MORH was repaid.

(7) On 19 December 1972 the directors of Holdings resolved that a declaration of solvency be sworn by a majority of the directors and lodged with the Registrar of Companies and that an extraordinary general meeting of Holdings be convened for the purpose of considering a resolution for winding up Holdings. On that date the declaration of solvency was duly sworn, notice of an extraordinary general meeting to be held on 21 December 1972 circulated, and the members of Holdings consented to the said meeting being held at short notice.

(8) At an extraordinary general meeting of Holdings duly convened and held on 21 December 1972 a special resolution that Holdings be wound up voluntarily as a members' voluntary winding-up and that Thomas Norman Ritchie be appointed liquidator and an extraordinary resolution that the liquidator be authorised to divide among the members in specie all or part of the assets of Holdings were passed.

(9) The winding-up of Holdings was conducted by the liquidator and in the course of such winding-up the only asset of Holdings, namely, cash in the sum of £296,728.50, was distributed to its members on 29 December 1972. Holdings was subsequently dissolved.

(10) On 24 September 1974 Burmah elected, pursuant to the provisions of para 25(1), Sch 6, Finance Act 1965, that the chargeable gains in relation to the disposal of the shareholding in Holdings in the beneficial ownership of Burmah be calculated by reference to the market value of the holding on 6 April 1965.

(11) The calendar year 1972 constituted an accounting period of Burmah for the purposes of corporation tax. Apart from the facts hereinbefore set out, Burmah had net chargeable gains in that period amounting to £3,397,724."

The Special Commissioners then go on to tell us that it was common ground between the parties that the transactions described in the findings in fact were carried out correctly as planned and were genuine transactions.

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A In these circumstances the particular contention of the taxpayer Company which the Special Commissioners upheld was (i) that the transactions set out in finding (6) constituted a reorganisation of the share capital of Holdings within the meaning of para 4(1) of Sch 7 to the Finance Act 1965; (ii) that, accordingly, by virtue of the provisions of para 4(2) of that Schedule, it fell to be deemed that there had been, *inter alia*, no acquisition by the taxpayer
B Company (for capital gains tax purposes) of the shares allotted to them by virtue of the rights issue, and that their original shareholding, together with the shares so allotted to them, became a “new holding”—a single asset—and fell to be treated “as the same asset acquired as the original shares were acquired”; (iii) that by virtue of para 4(3) of the same Schedule the cash actually
C paid for the rights issue of Holdings’ shares fell to be treated as having been given as consideration for the original shares; and (iv) that that consideration was deductible, in terms of para 4(1)(a) of Sch 6 to the Act, in computing the allowable loss on the disposal of the taxpayer Company’s entire “new holding” upon the liquidation of Holdings.

Before us Counsel for the Crown renewed none of the arguments which had been advanced on the Crown’s behalf before the Special Commissioners
D and, upon an entirely new ground, submitted that the Special Commissioners had erred in law in holding, on the facts in this case, that the cash actually paid by the taxpayer for the rights issue shares allotted to them, in the reorganisation of Holdings’ share capital, fell to be treated as “consideration” for the original shares. The starting point of the submission was the proposition, which Counsel for the Respondents did not dispute, that at the date of the
E reorganisation the taxpayer Company and Holdings did not transact at arm’s length. Accordingly, so ran the argument in broad terms, s 22(4)(a) came into play and, upon a proper construction of paras 4(2) and 4(3) of Sch 7 read together with s 22(4), the relevant consideration which was deductible on the disposal of the entire new holding was not the cash paid but the market value (if any) of the rights issue shares at the time of the reorganisation. Before
F considering this submission further, however, it will, we think, be convenient to set out the statutory provisions upon which it depended. Paragraph 4 of Sch 7 is concerned with, *inter alia*, reorganisation of share capital, and in para 4(1)(b) “original shares” are defined and the expression “new holding” is declared to mean, in relation to “original shares”, “the shares . . . of the company which, as the result of the reorganisation . . . represent the ‘original shares’”.

G Paragraph 4(2) provides, so far as is relevant:

“Subject to the following sub-paragraphs, a reorganisation of a company’s share capital shall not be treated as involving any disposal of the original shares or any acquisition of the new holding or any part of it, but the original shares (taken as a single asset) and the new holding (taken as a single asset) shall be treated as the same asset acquired as the
H original shares were acquired.”

Paragraph 4(3) provides, so far as is relevant:

“Where, on a reorganisation . . . of a company’s share capital, a person gives or becomes liable to give any consideration for his new holding or any part of it, that consideration shall in relation to any disposal of the new holding or any part of it be treated as having been given for the
I original shares, and if the new holding or part of it is disposed of with a

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liability attaching to it in respect of that consideration, the consideration given for the disposal shall be adjusted accordingly; . . .” A

Section 22(4) is, for the purposes of this case, in these terms:

“Subject to the provisions of this Part of this Act, a person’s acquisition of an asset and the disposal of it to him shall for the purposes of this Part of this Act be deemed to be for a consideration equal to the market value of the asset—(a) where he acquires the asset otherwise than by way of a bargain made at arm’s length . . .” B

Against this statutory background the submission for the Crown which we have already introduced briefly can be summarised as follows. The question is how para 4 of Sch 7 applies to the particular transaction which left the taxpayer Company with a “new holding”. Because of the opening words of para 4(2)—“Subject to the following sub-paragraphs”—one must begin by looking at para 4(3). Although para 4(3) does not say so expressly it is concerned with consideration *for the acquisition* of a person’s new holding or any part of it on a reorganisation of a company’s share capital. For the purposes of para 4(3), accordingly, it must be recognised that the taxpayer Company, at the time of the reorganisation of Holdings’ share capital, acquired an asset consisting of the “new holding” including the rights issue shares. That asset so acquired was acquired by the taxpayer Company otherwise than by way of a bargain made at arm’s length. Section 22(4) must therefore be taken into account with the result that where para 4(3) speaks of consideration it speaks in this case of the consideration prescribed by s 22(4), i.e. a sum equal to the market value of the additional shares allotted. It is only when the matters dealt with in para 4(3) have been resolved that one can go back to para 4(2) and it is only at that stage, when it has been discovered what consideration for the acquisition of the additional shares falls to be treated as having been given for the “original shares” when the “new holding” is disposed of, that one returns to para 4(2) to find that the reorganisation of capital itself is to be treated as not having involved any disposal of “original shares” or any acquisition of the “new holding” or any part of it, and that the “original shares” and the “new holding” are to be treated as a single asset. C D E F

One can readily understand the feeling of the Crown that the taxpayer Company should not, in the circumstances, “get away” with a huge allowable loss based on the cash paid for the shares issued by Holdings on their reorganisation of share capital. We cannot, however, decide this appeal merely upon the basis of such a feeling, however much we might share it, and we have reached the conclusion without hesitation that the new argument presented for the first time on behalf of the Crown is ingenious but unsound. G

There appear to us to be very great practical difficulties in applying s 22(4) to a reorganisation of capital and to a rights issue in which consideration has usually little relation to value. A much more complicated provision than s 22(4) would be required for this situation to deal with the revaluation of original shares to reflect the dilution of their value as the result of the reorganisation of capital. Whether or not these observations are sound, however, the question for us is one of construction of the relevant statutory provisions and when one begins with s 22(4) in which the opening words are “subject to the provisions of this Part of this Act” (which includes those of Sch 7) one sees at once that it applies where there has been an “acquisition of an asset”. H I

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- A The word “acquisition” there used means, and can only mean, “acquisition” in the statutory sense, namely, an acquisition for capital gains tax purposes. The question accordingly comes to be whether on any proper construction of paras 4(2) and 4(3) of Sch 7 the provisions of para 4(3) are concerned at all with such an acquisition. The correct approach is to look at para 4(2) first, always bearing in mind that it must be read subject to, *inter alia*, para 4(3). It
- B appears first for, we think, obvious reasons, and it proceeds on the view that you cannot look upon the acquisition of rights issue shares on their own. No doubt there is, in ordinary parlance, an acquisition of such shares in a reorganisation of share capital, but what para 4(2) tells us quite clearly is that the reorganisation is not to be treated—and this must mean for capital gains tax purposes—as involving any acquisition of “the new holding or any part of it”.
- C It then provides that the original shares and the new holding are to be treated as the same asset “acquired as the original shares were acquired”. That then is the only statutory acquisition. What para 4(2) does not tell us, however, is what is to be done about the consideration given for extra shares which, by virtue of that sub-paragraph, are to be treated as not having been acquired in any statutory acquisition. The purpose of para 4(3) is to give the answer to that question which, of course, arises in consequence of what has been provided in para 4(2). In view of para 4(2) it would have been surprising if para 4(3) had mentioned the word “acquisition” at all. It does not do so and the absence of that word is clearly by design. In effect para 4(3) properly construed is prescribing how to treat the consideration actually given (for that is what para 4(3) says) for something which, because of para 4(2), is not to be regarded
- E as an acquisition of an asset for capital gains tax purposes. The construction for which the Crown contended and upon which the attempted application of s 22(4) depended, involves reading into para 4(3) words which are not there, and which, on our construction of para 4, appear to have been deliberately omitted. If indeed there was, at the time of the reorganisation, an acquisition for capital gains tax purposes, there would be no need to treat the consideration therefor as having been given for the “original shares”. In short, there is nothing in the language of paras 4(2) and (3) read together in the logical order of their appearance to entitle one to apply s 22(4) to the events which happened at the time of the reorganisation of capital. The only relevant statutory acquisition is the acquisition of the original shares, and to the deemed acquisition of the “new holding” s 22(4) cannot, on the findings in this case,
- G be applied at all.

Upon the whole matter, the Special Commissioners were, in our judgment, entitled to hold that the cash paid for the additional shares in Holdings fell to be treated, on the disposal of the “new holding”, as having been given as consideration for the original shares. The question in the Case is not happily expressed and, in refusing the appeal, we shall answer it in the affirmative as if it had read: “Whether we were entitled to determine the assessment as set out in para VII.9 of the case.”

Appeal dismissed, with expenses.

The Crown’s appeal was heard in the House of Lords (Lords Diplock, Fraser of Tullybelton, Scarman, Roskill and Brandon of Oakbrook) on 5 November 1981 when judgment was reserved. On 3 December 1981, judgment was given unanimously in favour of the Crown.

The Lord Advocate (Lord Mackay of Clashfern Q.C.), R. Carnwath and A. C. Hamilton for the Crown.

D. C. Potter Q.C. and W. D. Prosser Q.C. for the Company.

The cases cited in argument are referred to in the speeches.

Lord Diplock—My Lords, I agree with the reasons for allowing this appeal that will be given in the speech of my noble and learned friend Lord Fraser of Tullybelton. Like him I can find no flaw in the construction placed by the Court of Session on the relevant provisions of the Finance Act 1965; but like him I also think that this case falls within the principle recently enunciated in the reasons for the decision of this House in *W. T. Ramsay Ltd. v. Commissioners of Inland Revenue*(¹) [1981] 2 WLR 449, to which my noble and learned friend was party. It is only in deference to the Court of Session that I venture to add a brief comment of my own, since their decision is being reversed upon a ground that was never argued before them and at the time of the hearing, which was after *Commissioners of Inland Revenue v. Plummer*(²) [1980] AC 896 but before *Ramsay's* case had been determined by this House, may well have not been open to the Court of Session.

It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax-avoidance schemes to assume, that *Ramsay's* case did not mark a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable. The difference is in approach. It does not necessitate the over-ruling of any earlier decisions of this House; but it does involve recognising that Lord Tomlin's oft-quoted *dictum* in *Commissioners of Inland Revenue v. Duke of Westminster*(³) [1936] AC 1 at page 19, "Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be", tells us little or nothing as to what methods of ordering one's affairs will be recognised by the courts as effective to lessen the tax that would attach to them if business transactions were conducted in a straight-forward way. The *Duke of Westminster's* case was about a simple transaction entered into between two real persons each with a mind of his own, the Duke and his gardener—even though in the nineteen-thirties and at a time of high unemployment there might be reason to expect that the mind of the gardener would manifest some degree of subservience to that of the Duke. The kinds of tax avoidance schemes that have occupied the attention of the courts in recent years, however, involve inter-connected transactions between artificial persons, limited companies, without minds of their own but directed by a single master-mind. In *Ramsay* the master-mind was the deviser and vendor of the tax avoidance scheme; in the instant case it was Burmah, the parent company of the wholly-owned subsidiary companies between which the pre-ordained series of transactions took place. Burmah was acting in accordance with advice obtained from advisers of the highest integrity who, in reliance on Lord Tomlin's *dictum*, did not foresee the difference in approach to tax avoidance

(¹) Page 101 *ante*. (2) 54 TC 1. (3) 19 TC 490.

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- A schemes involving inter-company transactions that would have been adopted by this House by the time some nine years later when the particular scheme that they had devised in 1972 was eventually to come before it.

- As will appear from the analysis of the intra-group transactions in the speech of my noble and learned friend, Lord Fraser of Tullybelton, the only real asset involved in the whole series of transactions was Burmah's holding of B.P. shares. Whether if Burmah had sold these shares in 1972, the relevant tax year, to some third party it would have realised a capital loss for the purpose of corporation tax on capital gains, which I will refer to as capital gains tax and, if so, what that loss would have been we do not know; it continued to retain the shares. By two previous transactions, undertaken for good commercial reasons with its wholly-owned subsidiary Holdings, it had transferred the shares to Holdings at market price and subsequently transferred them back again to Burmah at a time when the market price had fallen, as a result of which there were entries in the books of both parent and subsidiary companies which showed an unsecured indebtedness by Holdings to Burmah of the order of £160,000,000. This represented the extent of Holding's insolvency since it had no assets out of which to pay this sum. A bad debt which is not a debt on a security is not a deductible loss for the purposes of capital gains tax; so a scheme was designed to convert this debt into a loss on realisation of Burmah's shares in Holdings on liquidation of that company. The essence of the scheme was that Burmah should subscribe £160,000,000 for a rights issue of fresh shares in Holdings, thus putting it into a position to make a declaration of solvency and go into voluntary liquidation. The £160,000,000 was the subject of two circles of book entries described by my noble and learned friend, in the course of which the £160,000,000 indebtedness of Holdings to Burmah was transmogrified into a loss of the same amount (less a minor difference) upon the realisation of Burmah's shares in Holdings upon the voluntary liquidation of the latter company. I agree with Lord Fraser of Tullybelton that the approach to tax avoidance schemes of this character sanctioned by *Ramsay*(1) entitles your Lordships to ignore the intermediate circular book entries and to look at the end result, which was that Burmah wrote off Holdings' indebtedness to it of £160,000,000 by itself providing Holdings with the money to pay it, ostensibly in the form of fresh capital. The real loss it sustained was of a debt not on a security.

- Lord Fraser of Tullybelton**—My Lords, this is an appeal from an interlocutor of the Court of Session as the Court of Exchequer in Scotland. The appeal raises two issues. The first is one of pure construction of the statutory provisions relating to capital gains tax (or corporation tax in this case as the taxpayer is a limited company). The second issue raises a question with wider implications as to whether certain transactions, which on the face of them and according to the taxpayer's submission, resulted in an allowable capital loss, should be disregarded as artificial. The second issue was raised for the first time in the Appellants' printed case for your Lordships' House; it is founded on the decision of the House in the recent case of *W. T. Ramsay Ltd. v. Commissioners of Inland Revenue* [1981] 2 WLR 449, which was later in date than the decision of the Court of Session now under appeal.

The Appellants are the Commissioners of Inland Revenue. The Respondent is the Burmah Oil Co. Ltd. ("Burmah"). Burmah was assessed to

(1) Page 101 *ante*.

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corporation tax for its accounting period ended 31 December 1972 in a sum of over £3,000,000. Burmah appealed to the Special Commissioners against the assessment, the question of principle being whether, for the purpose of computing its capital gain for corporation tax purposes, there had accrued during that accounting period a substantial allowable capital loss. The Special Commissioners allowed the Respondent's appeal in principle and the figures were agreed. The Appellants appealed to the Court of Session and on 13 November 1980 their appeal was refused by the First Division (the Lord President, Lord Cameron and Lord Stott). They now appeal to this House.

The facts are fully set out in the Case stated by the Special Commissioners for the opinion of the court, and I shall summarise them now only to the extent necessary to explain my opinion. Burmah was at all material times the parent company of several companies including OMDR Holdings Ltd. ("Holdings"), Manchester Oil Refinery Holdings Ltd. ("MORH"), and Burmah Oil Trading Ltd. ("BOTL"). It was the beneficial owner of all the issued shares in Holdings, of which 700,000 were held in its own name, and one share was held in name of BOTL as its nominee. Holdings' share capital of 700,001 shares was represented by a debt of that amount owed to Holdings by Burmah. Holdings never traded, and the purchase and sale transactions to be described below were the only functions it ever carried out. In March 1969 Burmah, to secure certain fiscal advantages by way of relief under s 84 of the Finance Act 1965, sold and transferred to Holdings a substantial amount of stock which it held in the British Petroleum Co. Ltd. The purchase price £380,625,000, was left outstanding as a debt due by Holdings to Burmah. After deduction of the debt of £700,001 owed by Burmah to Holdings the amount outstanding on loan account and due by Holdings to Burmah was £379,924,999. In April 1971, for good commercial reasons, the BP stock was re-sold and transferred back by Holdings to Burmah. The market value of the BP stock had fallen since March 1969 and the price on re-sale was £220,625,000. As a result of the lower price on re-sale there remained at the completion of that transaction a large balance outstanding as a loan due by Holdings to Burmah amounting to £159,299,999. As Burmah and Holdings were members of the same group of companies the transactions between them in March 1969 and April 1971 gave rise neither to chargeable gains nor to allowable losses (see Income and Corporation Taxes Act 1970, s 273(1)). That is the point at which the events giving rise to this appeal begin. These events took place about two years before the BP shares were sold by Burmah to the Bank of England in circumstances which later led to controversy and to separate litigation. That sale has no connection with or bearing upon the issues in this appeal. After the repurchase of the BP shares from Holdings Burmah explored with Counsel the possibility of obtaining for corporation tax purposes an allowable loss by turning to account the situation which had arisen on the repurchase. The events that followed were carried out in accordance with a pre-arranged scheme, approved by Burmah's directors, to achieve that end. The Special Commissioners found as a fact that the material events "took place in the following order (the timetable, draft minutes and draft letters having been prepared in advance)". The following finding of the Special Commissioners should also be quoted:

"At the material times there was to a very great extent a common membership between the boards of Burmah, Holdings, MORH and BOTL. . . . The transactions . . . were carried out correctly as planned and were genuine transactions."

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- A On Tuesday, 12 December 1972, a series of events took place, of which the essential ones were these. MORH obtained from Burmah a loan of £159,299,999, being the exact amount of the debt owed by Holdings to Burmah. MORH then lent that amount to Holdings which in turn and on the same day repaid its debt to Burmah. The money thus went round in a small circle and returned to its starting point on the same day. The effect so far was that instead of Burmah
- B being a direct creditor of Holdings for the sum I have mentioned, MORH were now interposed as creditor of Holdings and debtor of Burmah for that amount. On Monday, 18 December, another series of events took place of which the essential ones were these. (I omit reference to the various meetings of directors and to an extraordinary general meeting of Holdings which were all duly held and which passed the appropriate resolutions.) Holdings made a rights issue
- C of shares to its existing shareholders of 700,001 unissued ordinary shares of £1 each at £228 *per* share, in proportion to their existing holdings. Burmah applied for and was allotted 700,000 for which it paid £159,600,000 and BOTL applied for and was allotted one share for which it paid £228. I note in passing that the issue price of £228 *per* share which produced the total sum of £159,600,228 was the lowest price in complete pounds which when multiplied by 700,001 would produce more than £159,299,999. On the same day (18 December 1972), Holdings repaid to MORH the loan of £159,299,999 and MORH repaid that same amount to Burmah. That sum thus went round the same circle as the money on 12 December but in the opposite direction. The effect of these events was to eliminate the train of debts and to restore Holdings to solvency. On 19 December 1972, Holdings took the first steps towards voluntary liquidation.
- E On 29 December its only asset, a cash sum of £296,728.50 (being the balance of £300,229 of cash subscribed for its new shares after repaying its debt to MORH, less capital duty of £3,500.50 on its increased capital) was distributed to its members. Holdings was later dissolved.

- The first question is whether in the circumstances described above, Burmah is entitled when computing the chargeable gain or allowable loss arising to it
- F on the disposal of its shares in Holdings, on the liquidation of Holdings, to deduct in addition to the cost of acquiring the original shares the sum of £159,600,228 paid by way of subscription to the new shares. The Appellants contended that it is not, because the new shares were acquired "otherwise than by a bargain made at arm's length" and therefore the consideration for them must be deemed to be an amount equal to their market value, and not the sum
- G paid in cash—see Finance Act 1965, s 22(4). Burmah replies, in brief, that s 22(4) has no application in the circumstances of this case because the payment for the new shares issued on 18 December was made as part of a reorganisation of the capital of Holdings, in the sense of the Finance Act 1965, Sch 7, para 4(1), that the allotment of the new shares is not to be treated as an "acquisition" of these shares (para 4(2)) and that therefore there was no acquisition on which s 22(4) can bite. The Special Commissioners and the First Division have both
- H decided this issue against the Appellants, and I have no doubt they were right. The contention of the Appellants rests entirely on s 22(4) which, so far as relevant, provides as follows:

- I "(4) Subject to the provisions of this Part of this Act, a person's acquisition of an asset and the disposal of it to him shall for the purposes of this Part of this Act be deemed to be for a consideration equal to the market value of the asset—

(a) Where he acquires the asset otherwise than by way of a bargain made at arm's length and in particular where he acquires it by way of gift or by

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way of distribution from a company in respect of shares in the company, A
or . . .”

It was an essential part of the argument for the Appellants that Burmah had acquired an asset, consisting of the new shares, otherwise than at arm's length on 18 December 1972. But that argument is in my opinion fallacious. In the first place it assumes that the new shares were “the asset” acquired otherwise than by a bargain at arm's length. But for the purposes of the capital gains tax B the only relevant asset is the “holding” consisting of the totality of ordinary shares old and new in Holdings held by Burmah. That appears from the Finance Act 1965, Sch 7, para 2(1) which provides as follows:

“(1) Any number of shares of the same class held by one person in one capacity shall for the purposes of this Part of this Act be regarded as indistinguishable parts of a single asset (in this paragraph referred to as a holding) growing or diminishing on the occasions on which additional shares of the class in question are acquired, or some of the shares of the class in question are disposed of.” C

In the second place the contention is contrary to the provisions of para 4 of Sch 7. The general statement which I have quoted from para 2(1) is followed by provisions relating particularly to reorganisation of share capital of a company. Paragraph 4 provides (relevantly) as follows: D

“4.—(1) This paragraph shall apply in relation to any reorganisation or reduction of a company's share capital; and for the purposes of this paragraph—(a) References to a reorganisation of a company's share capital include—(i) Any case where persons are, whether for payment or not, allotted shares in or debentures of the company in respect of and in proportion to (or as nearly as may be in proportion to) their holdings of shares in the company or of any class of shares in the company; and . . . (b) ‘original shares’ means shares held before and concerned in the reorganisation or reduction of capital, and ‘new holding’ means, in relation to any original shares, the shares in and debentures of the company which as a result of the reorganisation or reduction of capital represent the original shares (including such, if any, of the original shares as remain).” E F

There is no doubt that the rights issue by Holdings on 18 December 1972 was a reorganisation of its capital in the sense of that paragraph.

Paragraph 4(2) is the sub-paragraph which is of most direct importance for the present purpose. It reads as follows:

“(2) Subject to the following sub-paragraphs, a reorganisation or reduction of a company's share capital shall not be treated as involving any disposal of the original shares or any acquisition of the new holding or any part of it, but the original shares (taken as a single asset) and the new holding (taken as a single asset) shall be treated as the same asset acquired as the original shares were acquired.” (Emphasis added.) G

The effect of that sub-paragraph is that the allotment of new shares in Holdings to Burmah is not to be treated as involving an “acquisition” of those shares, which form part, but not the whole, of the new holding. The words that I have emphasised in the quotation are in my opinion conclusive against the Appellant's argument on this point, for as the allotment of new shares is not to be treated as an acquisition of any part of the new holding, s 22(4) which deals only with a person's “acquisition” of an asset cannot apply to it. I agree therefore with H I

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A the learned Judges of the First Division that the contention of the Appellants based upon s 22(4) fails.

The explanation of how the consideration given for the new holding "or any part of it" (such as the newly allotted shares in this case) is to be treated for capital gains tax is contained in para 4(3). The Lord President in his opinion drew attention to the absence of the word "acquisition" from para 4(3). He said that in view of para 4(2) it would have been surprising if para 4(3) had mentioned the word "acquisition", and he added that the absence was clearly by design. With great respect, I do not think that is right if, in saying "by design", the learned Lord President meant to convey that it was in order to fit in with para 4(2). Paragraph 4(3) provides that if a person gives "any consideration for his new holding or any part of it, that consideration shall . . . be treated as having been given for the original shares". The latter phrase is, in my opinion, only a shorthand reference back to Sch 6, para 4(1)(a) which deals with the value of the consideration "given . . . wholly and exclusively for the *acquisition* of the asset". The same must be true of the former phrase, because only if the consideration "given for" the new shares is treated as having been given wholly and exclusively for the acquisition of the original shares can it be allowable as a deduction in the computation of capital gain under para 4(1) of Sch 6. But although I am, for that reason, unable to agree with the learned Lord President's comment on the design underlying para 4(3), that does not detract in any way from my agreement with his conclusion about the effect of para 4(2).

If the matter rested there I would simply have agreed with the decision of the First Division. But it becomes necessary now to consider the new point raised in your Lordships' House as to the applicability of the principles stated by this House in the cases of *Ramsay* and *Eilbeck*⁽¹⁾ reported together at [1981] 2 WLR 449. The general features of the schemes in those cases were described by Lord Wilberforce at page 455E, and Mr. Potter on behalf of Burmah stated, rightly in my opinion, that in some respects they differed considerably from the scheme in the present case. One difference is that in those cases the taxpayers had been provided with "a preconceived and ready-made plan" whereas in the present case the plan, though preconceived, was specially tailor-made for Burmah. But that difference cannot affect the legal position. Again, in those cases it was the clear and stated intention that, once started, each scheme would proceed to completion and would not be arrested half-way. In the present case it was said that the first series of events, those occurring on 12 December 1972, could have stood on their own, and need not have been followed by the second series on 18 December. I think that is correct although it would have involved abandoning the overall scheme at the half-way stage. But it is clear that the events initiated on 18 December formed part of a single scheme and I have already quoted the finding by the Special Commissioners that they took place in the order and according to a timetable prepared in advance. They made a similar finding about the events of 12 December 1972. Counsel for Burmah submitted that there was no necessity for even those steps taken on 18 December to have all been carried out, and he referred to a minute of a meeting of a committee of directors of Burmah, held on 18 December 1972, which records the chairman as saying that "a choice lay before the directors" of subscribing for the new shares being offered by Holdings or of dealing with "the problem" in some other way. No doubt the directors could have chosen,

(1) Page 101 *ante*.

(Lord Fraser of Tullybelton)

even at that stage, to abandon the scheme but the reality was that the decision had already been taken to carry it through to completion, and that was unquestionably the intention of the directors in this case, just as it was the intention of all parties concerned in *Ramsay*⁽¹⁾ and in *Chinn v. Hochstrasser*⁽²⁾ [1981] 2 WLR 14. In one respect I accept that this scheme differed from those in *Ramsay* and *Eilbeck*. In both those cases the money required for the various transactions had been provided by loans, which were so arranged and secured as to raise doubts as to whether any real money existed at all. In the present case the necessary money was provided by Burmah, and its two circular journeys on 12 and 18 December undoubtedly took place as represented by entries in the bank statements. One element of unreality which existed in *Ramsay* and *Eilbeck* is therefore absent here, but its absence is not, in my opinion, of material importance. Finally, as Lord Wilberforce said at page 456 in *Ramsay*⁽³⁾, it was “candidly, if inevitably, admitted that the whole and only purpose of each scheme was the avoidance of tax”. The same admission was made here and the same adverbs apply. But the fact that the purpose of the scheme was tax avoidance does not carry any implication that it was in any way reprehensible or other than perfectly honest and respectable. It was the duty of Burmah’s directors to take such lawful steps as were open to them to minimise the impact of tax on the company’s profits, and in carrying out this scheme they acted upon professional advice from reputable sources. If the advice in this regrettably intricate region of law turned out to be erroneous, they are not to be criticised on that account. The ratio of the decision in *Ramsay* is to be found in the speech of Lord Wilberforce at page 459E where he said this:⁽⁴⁾

“The capital gains tax was created to operate in the real world, not that of make-belief. As I said in *Aberdeen Construction Group Ltd. v. Inland Revenue Commissioners*⁽⁵⁾ [1978] AC 885, it is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences. To say that a loss (or gain) which appears to arise at one stage in an indivisible process, and which is intended to be and is cancelled out by a later stage, so that at the end of what was bought as, and planned as, a single continuous operation, is not such a loss (or gain) as the legislation is dealing with, is in my opinion well and indeed essentially within the judicial function.”

At page 469H of the same case⁽⁶⁾ I said this with reference to the cases of *Commissioners of Inland Revenue v. Plummer*⁽⁷⁾ [1980] AC 896 and *Chinn v. Hochstrasser* [1981] 2 WLR 14:

“The essential feature of both schemes was that, when they were completely carried out, they did not result in any actual loss to the taxpayer. The apparently magic result of creating a tax loss that would not be a real loss was to be brought about by arranging that the scheme included a loss which was allowable for tax purposes and a matching gain which was not chargeable.”

The question in this part of the appeal is whether the present scheme, when completely carried out, did or did not result in a loss such as the legislation is dealing with, which I may call for short, a real loss. In my opinion it did not. The problem for Burmah arose from the fact that, owing to the decline in value of the BP shares while they were held by Holdings, Holdings was left with a debt of £159,299,999 owing to Burmah after selling the BP shares back to them.

(1) Page 101 *ante*. (2) TC Leaflet 2817. (3) Page 184 *ante*. (4) Page 187 *ante*.
 (5) 52 TC 281. (6) Page 197 *ante*. (7) 54 TC 1.

(Lord Fraser of Tullybelton)

- A That was a simple debt, not “the debt on a security” and therefore no allowable loss could accrue to Burmah on a disposal of the debt—see Finance Act 1965, Sch 7, para 11(1), which refers only to chargeable gains but which applies also to allowable losses—see s 23(1). The purpose of the scheme was to convert that non-allowable loss into a loss that would be allowable as a deduction for capital gains purposes. In the course of argument much emphasis was laid by Counsel
- B for Burmah on the harsh, even unfair, consequences of para 11(1), particularly as they depend on whether a bad debt happens to be “the debt on a security” or not. That may be a pure accident, as the difference in the case of a wholly-owned subsidiary company is usually of no commercial importance. The possibility of hardship was noticed in the speeches in this House in the *Aberdeen Construction Group* case⁽¹⁾, *supra*, but any hardship, if it exists, is, in my opinion,
- C irrelevant. In the present case, there is little or no hardship because, after the scheme had been carried through, Burmah still owned the BP shares, and if it had disposed of them in December 1972 by selling them to a party outside its own group, it would have made an allowable loss ascertained by reference to the original purchase price of the shares, disregarding the intervening sale to and re-purchase from Holdings. The true position was that on the BP shares
- D it had a real, but unrealised, loss. In considering the scheme, it seems to me immaterial whether the series of events that occurred on 12 December are included or not. I have already mentioned that their effect was merely to interpose MORH between Burmah and Holdings as debtor of Burmah and creditor of Holdings. These events were merely the preliminary to the main part of the scheme. They may have been a necessary preliminary so that the directors of
- E Holdings could sign the declaration of solvency leading up to a voluntary liquidation, but the fact that they were taken cannot, so far as I can see, strengthen the argument for Burmah, and I did not understand their Counsel to rely upon them. I shall, therefore, follow the example of the Lord Advocate and pay no further regard to those events.

- The second series of events began on 18 December 1972. On that date,
- F Burmah paid £159,600,000 to Holdings and in return it received 700,000 new shares in Holdings. Burmah say that the money was paid in consideration for the shares, and so it was up to that stage. But there were later stages to come before the scheme was complete. Most of the money (£159,299,999) was immediately passed on by Holdings to MORH, and by MORH back to Burmah on the same day. On 19 December, Holdings took the first steps towards
- G voluntary liquidation, and on 29 December its only asset, consisting of a cash balance of £296,728.50, was distributed to its members, that is, to Burmah either directly or through BOTL, and Holdings was wound-up. Burmah’s shares in Holdings were thus destroyed. The result was that although Burmah apparently suffered the loss of almost the whole price that it had paid for the new shares, except for the cash balance returned on liquidation, it suffered no
- H real loss because it got back all the money except the capital duty of £3,500.50 on the 700,001 new shares. Moreover, it still had the BP shares which it could have realised in the open market at a loss on their original purchase price. If the argument for Burmah is right, this would be one more case in which the taxpayer had achieved the apparently magic result of creating a tax loss that was not a real loss. In my opinion they have not achieved that result because,
- I in the same way as in *Ramsay’s* case⁽²⁾, when the scheme was carried through to completion there was here no real loss and no loss in the sense contemplated by the legislation.

(1) 52 TC 281. (2) Page 101 *ante*.

(Lord Fraser of Tullybelton)

I would allow the appeal. A

If your Lordships agree with my view, the Appellants will have succeeded on a point that was not argued in the Court of Session, and which, even if it was technically open there, would not have been normally regarded as arguable in that Court. For that reason, I would make no order for costs in this House, and I would not disturb the order for expenses in the Court of Session contained in the interlocutor of 13 November 1980. B

Lord Scarman—My Lords, I also would allow the appeal. I have had the advantage of reading in draft the speeches of my noble and learned friends, Lord Diplock and Lord Fraser of Tullybelton. I agree with the reasons they give for allowing the appeal.

I wish, however, to make two comments. First, it is of the utmost importance that the business community (and others, including their advisers) should appreciate, as my noble and learned friend Lord Diplock has emphasised, that *Ramsay's* case⁽¹⁾ marks “a significant change in the approach adopted by this House in its judicial role” towards tax avoidance schemes. Secondly, it is now crucial when considering any such scheme to take the analysis far enough to determine where the profit, gain, or loss is really to be found. “The true position” was, as my noble and learned friend Lord Fraser of Tullybelton has said, that owing to the fall in value of the BP shares Burmah suffered a real, but unrealised, loss. Put in the language of capital gains taxation, there never was a disposal of the real asset, i.e. the BP shares, though there was, of course, a disposal (on liquidation) of the nominal asset, i.e. Burmah's share holding in Holdings. C
D

Lord Roskill—My Lords, I have had the advantage of reading in draft the speeches of my noble and learned friends Lord Diplock and Lord Fraser of Tullybelton. For the reasons they give I, too, would allow this appeal with the consequences which have been proposed. E

Lord Brandon of Oakbrook—My Lords, I have had the advantage of reading in draft the speeches of my noble and learned friends, Lord Diplock and Lord Fraser of Tullybelton. I agree with them and would allow the appeal, with the consequences proposed, accordingly. F

Appeal allowed, order as to expenses in the Court of Session not disturbed, no order as to costs in the House of Lords.

[Solicitors:—Messrs. Allen & Overy, agents for Messrs. Miller Thompson Henderson & Co. Glasgow and Messrs. Laing & Motherwell W. S. Edinburgh; Solicitor of Inland Revenue.]

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(1) Page 101 *ante*.