

A COURT OF APPEAL—6, 7 AND 16 DECEMBER 1994

B HOUSE OF LORDS—10 MARCH AND 10 JULY 1997

Commissioners of Inland Revenue v. Willoughby⁽¹⁾

C
 D *Income Tax—Avoidance—Transfer of assets abroad—Investments in offshore funds—Investments made both before and after taxpayers became resident in UK—Later investments subject to a specific tax régime—Whether anti-avoidance provision applied to transfers of assets made by transferor not resident in the UK—Whether exemption applied because avoiding tax not the purpose or one of the purposes of the transfer of assets—Income and Corporation Taxes Act 1988, ss 553, 739, 741–743.*

E Following W's early retirement from his post as a professor in Hong Kong, W (in 1987) and his wife (in 1986) returned to, and became resident and ordinarily resident in, the UK.

F Prior to returning W invested a sum in a single premium personal portfolio bond with RLII, an Isle of Man company, under which there were issued to W policies of insurance linked to a fund, the investments in which were decided upon by, and subject to change by decision of, an investment adviser appointed by W.

G In 1989 and 1990 further similar bonds were purchased on Mrs. W's application with the proceeds accruing on the maturity of certain 10-year policies, the company concerned transferring investments *in specie* to the funds linked to the further bonds. Also in 1990 further policies were issued under the first bond in return for further investments added to the fund linked to that bond.

H Before making the investments W had been aware of the provisions for taxing in the hands of a policy holder the income and capital gains of an offshore fund underlying the policy, as applied by s 553(7) Income and Corporation Taxes Act 1988 (originally introduced in 1984) to non-resident policies and offshore capital redemption policies, but he was not aware of s 739 of the 1988 Act (or its predecessors). Before making the investments in 1989 and 1990 W had had advice from his investment manager which offered three options, and he had taken the third option.

I W appealed against assessments to income tax for 1987–88 to 1990–91 made under s 739 (or its predecessor) and Mrs. W appealed against a like assessment for 1990–91. The Special Commissioners allowed the appeals, holding, amongst other things, that if in 1989 W had appreciated any serious risk of application of s 739, he would have selected the second investment

(1) Reported (CA) [1995] STC 143; (HL) [1997] 1 WLR 1071; [1997] 4 All ER 65; [1997] STC 995.

option suggested to him rather than the third. The Crown appealed. Pursuant to a certificate made by the Special Commissioners under para 2 of the Revenue Appeals Order 1987, the appeal was heard directly by the Court of Appeal. A

The Court of Appeal held, dismissing the Crown's appeal, that:— B

(1) section 739 did not apply in relation to the first bond because it cannot apply to a transfer of assets made by a transferor at any time when he is not ordinarily resident in the UK; the logic of the decision in *Vestey v. Inland Revenue Commissioners* [1980] AC 1148; 54 TC 503 is that s 739(1) should be construed so that "effected by him" should be interpolated after "transfer of assets"; moreover the majority of the speeches in that case indicate an approach which refers not to the point of time at which the tax is avoided or to the achievement of that purpose but rather to the act which initiates that result or the point of time when the transfer which enables the subsequent avoidance to be achieved is carried out, and, as the individual in question has to be ordinarily resident in the UK at whatever is the relevant time, it followed from this that the transferor must be so resident at the time of the transfer; C
D

(2) the exemption in s 741(a) applied in respect of the later bonds and of the 1990 additions in relation to the first bond because:

(a) the bonds or policies were within the régime imposed by s 553 of the 1988 Act and it is not a statutory condition for the application of that régime that the investments to which a policy or bond is linked must be pooled or chosen by someone other than the holder; there is no material difference between the position of W and Mrs. W and the others with bonds or policies in respect of which the Revenue seek to raise assessments under s 739 because choice of and control over the underlying investments is retained and the position of those holding offshore bonds or policies where there is no such retention and which are accepted to satisfy s 741; E
F

(b) it was not one of the purposes of the transfer or of the associated operations by which W and Mrs. W effected any of the bonds or policies with RLII that liability to taxation should be avoided; the genuine application of a taxpayer's money in the acquisition of a species of property for which Parliament had determined a special tax régime did not amount to tax avoidance merely on the ground that the taxpayer might have chosen a different application which would have subjected him to less favourable tax treatment. G
H

Per curiam: a consideration of the forensic and legislative history showed that the reports of the speeches of Ministers when introducing the legislation in 1936, even if the conditions laid down in *Pepper v. Hart* [1993] AC 593; 65 TC 421 for allowing reference to such statements were complied with, were of no value. Whatever might have been the intention of Ministers in 1936 the Court had decided in 1948 and again in 1969 that the words used by Parliament manifested a different intention. Yet in the Consolidation Act of 1952 and again in the Consolidation Act of 1970 the same formula had been used and notwithstanding a change made in s 33 Finance Act 1969 to nullify the decision of the House of Lords in *Herdman v. Commissioners of Inland Revenue* 45 TC 394 on another point but leaving untouched the decision of the Court of Appeal in Northern Ireland in favour of the Revenue I

A on the issue whether the then predecessor of s 739 could apply to a transfer of assets made by a transferor not resident or ordinarily resident in the UK. In those circumstances, it must be assumed that the original intention, whatever it was, had been superseded by acceptance of the decisions of the courts.

B The Crown appealed.

Held, in the House of Lords, dismissing the Crown's appeal, that:—

C (1) section 739 did not apply in relation to the first bond because, although the point was not determined in *Vestey v. Inland Revenue Commissioners*, the view there taken that the individual to be charged must be the individual who made the transfer led inevitably to the conclusion that the individual concerned must be the only type of transferor with which s 739 was concerned, and that was a transferor ordinarily resident in the UK; that was the natural and plain meaning of the statutory words;

D *Vestey v. Inland Revenue Commissioners* [1980] AC 1148: 54 TC 503 applied. Decision of the Court of Appeal in Northern Ireland on this point in *Herdman v. Inland Revenue Commissioners* [1968] NI 74: 45 TC 394 overruled;

E (2) in respect of the later bonds and additions, the exemption in s 741(a) applied; there was a basic fallacy in the Crown's argument that the underlying reality of the matter was that the holder of a personal portfolio bond continued to manage and benefit from his own portfolio of investments, but, by the insertion of the bond structure, escaped tax on the income and gains from those investments as they arose; so far from the underlying investments being owned by the bondholder, he had no legal or equitable interest in them whatever; the reality in truth was that the bondholder had a contractual right to the benefits promised by the policy, no more and no less; the personal portfolio bondholder might fare better or worse in terms of benefits by reason of his control over investment policy than his fellow bondholder with the standard type of bond (which was accepted by the Crown to satisfy s 741(a)), but the difference between them had nothing to do with tax or with tax avoidance.

H 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.

I *Commissioners of Inland Revenue v. Peter Geoffrey Willoughby*

1. At a hearing before me sitting as a single Commissioner for the Special Purposes of the Income Tax Acts on 18, 19 and 20 January 1993, Peter Geoffrey Willoughby (hereinafter called "Professor Willoughby") appealed against the undermentioned assessments to income tax:

Year	Amount of assessment
1987-88	£5,566
1988-89	£1,594
1989-90	£881
1990-91	£254

For the year 1987-88 the income which formed the subject matter of the assessment was charged to tax under s 478 Income and Corporation Taxes Act 1970 (Transfer of assets abroad). For the remaining years the income was charged under s 739 Income and Corporation Taxes Act 1988 ("the Taxes Act") (the successor to s 478). No distinction was drawn between the two charging provisions. Hereafter I refer to s 739 of the Taxes Act unless the context otherwise requires.

2. At the same time as I heard the appeal of Professor Willoughby I heard also the appeal of Ruth Marylyn Willoughby, the wife of Professor Willoughby (hereinafter called "Mrs Willoughby"), against two assessments to income tax charged as aforesaid for 1986-87 and 1990-91 in the sums of £17,493 and £1,754 respectively. It was agreed between the parties that the assessment on Mrs Willoughby for 1986-87 should be discharged. Subject to that the issues in her appeal against the assessment for 1990-91 were the same as those in the appeal of Professor Willoughby. Their appeals were heard together.

3. The issues which arose are as follows:—

(1) Whether s 739 ("Prevention of avoidance of income tax") can apply to a transfer of assets made by a transferor at any time when he was not ordinarily resident in the United Kingdom.

(2) Whether s 739 can apply to a transfer of assets situated outside the United Kingdom made by a transferor at a time when he was ordinarily resident in the United Kingdom.

(3) Whether s 739 can apply to the income arising under a policy of life insurance to which the provisions of ss 539 to 554 of the Taxes Act are applicable.

(4) Whether the deferral of a liability to United Kingdom income tax can constitute the avoidance of liability to income tax for the purposes of s 739.

(5) Whether on the facts as found:

a) the purpose of avoiding liability to taxation was the purpose or one of the purposes for which the transfer of assets to Royal Life Insurance International Ltd. or any operation associated therewith was effected; or

b) that transfer and any operations associated therewith were bona fide commercial transactions and not designed for the purpose of avoiding liability to taxation.

(6) Whether the income and gains sought to be imputed to Professor Willoughby under s 739 are exempted from taxation in the United Kingdom by Article 3(2) of the Double Taxation Arrangement

A between the United Kingdom and the Isle of Man of 29 July 1955 (1955 S.I. No. 1205) as being the "industrial or commercial profits of a Manx enterprise".

B 4. Professor Willoughby was represented by Mr. Robert Carnwath Q.C. and Mr. Philip Baker. The Commissioners of Inland Revenue were represented by Mr. S. J. Tabbush of the Solicitor's Office, Inland Revenue.

C 5. Oral evidence was given by Professor Willoughby and on his behalf by Mr. David Thomas Wilkie who until 1987 was a director of Personal Financial Consultants Ltd. and has since that date been a director of Matheson PFC Ltd.

6. Paragraph (6) listed the documentary evidence.

D None of the documentary evidence is annexed hereto but copies of all or any of it are available for the Court if required.

E 7. At the conclusion of the hearing I reserved my decision which I gave on 23 March 1993. It is annexed hereto and forms part of this Case. The facts and contentions of the parties are set out in my decision. It will be seen therefrom that I decided the first and fifth issues in the negative in favour of Professor Willoughby and Mrs Willoughby and the second, third, fourth and sixth issues in favour of the Crown. I discharged all the assessments.

F 8. In addition to the cases referred to in my decision there were cited: *Astor v. Perry* [1935] AC 398; 19 TC 255; *Lord Vestey's Executors and Vestey v. Commissioners of Inland Revenue* 31 TC 1; [1949] 1 All ER 1108; *Ramsden v. Commissioners of Inland Revenue* 37 TC 619; *Sargent v. Barnes* [1978] STC 322; [1978] 1 WLR 823; 52 TC 335; *Sun Life Assurance Co. of Canada v. Pearson* [1986] STC 335; 59 TC 250.

G 9. After the determination of the appeal the Crown on 23 March 1993 expressed its dissatisfaction therewith as being erroneous in point of law and on 16 April 1993 required us to State a Case for the opinion of the High Court pursuant to s 56 of the Taxes Management Act 1970 which Case we have stated and I, the Commissioner who heard the appeal, do sign accordingly.

H 10. The questions of law for the opinion of the Court are:—

(a) whether I erred in answering in the negative the first question in issue set out in para 3 above and

I (b) whether there was no evidence upon which I could answer in the negative the fifth question in issue as aforesaid.

For the purposes of para 2 of the Revenue Appeals Order 1987 I certify that my decision involves a point of law relating wholly or mainly to the construction of an enactment which has been fully argued before me and fully considered by me.

D. A. Shirley

} Commissioner for the Special
 Purposes of the Income Tax
 Acts

15-19 Bedford Avenue
 London WC1B 3AS

31 August 1993

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.

Commissioners of Inland Revenue v. Ruth Marylyn Willoughby

1. At a hearing before me sitting as a single Commissioner for the Special Purposes of the Income Tax Acts on 18, 19 and 20 January 1993, Ruth Marylyn Willoughby (hereinafter called "Mrs Willoughby") appealed against assessments to income tax for 1986-87 and 1990-91 in the sums of £17,493 and £1,754 respectively charged under s 478 Income and Corporation Taxes Act 1970 (transfer of assets abroad) in the case of the earlier assessment and under s 739 Income and Corporation Taxes Act 1988 ("the Taxes Act") (the successor to s 478) in the case of the later assessment.

2. At the same time as I heard the appeal of Mrs Willoughby I heard also the appeal of Peter Geoffrey Willoughby, the husband of Mrs. Willoughby (hereinafter called "Professor Willoughby"), against assessments to income tax under the aforesaid statutory provisions as from time to time in force for the years 1987-88 to 1990-91 inclusive. It was agreed between the parties that the assessment on Mrs. Willoughby for 1986-87 should be discharged. Subject that the issues in Professor Willoughby's appeal were the same as those in the appeal of Mrs. Willoughby. Their appeals were heard together.

3. The issues which arose are as follows:—

(1) Whether s 739 ("Prevention of avoidance of income tax") can apply to a transfer of assets made by a transferor at any time when he was not ordinarily resident in the United Kingdom.

(2) Whether s 739 can apply to a transfer of assets situated outside the United Kingdom made by a transferor at a time when he was ordinarily resident in the United Kingdom.

(3) Whether s 739 can apply to the income arising under a policy of life insurance to which the provisions of ss 539 to 554 of the Taxes Act are applicable.

(4) Whether the deferral of a liability to United Kingdom income tax can constitute the avoidance of liability to income tax for the purposes of s 739.

(5) Whether on the facts as found:

A (a) the purpose of avoiding liability to taxation was the purpose or one of the purposes for which the transfer of assets to Royal Life Insurance International Ltd. or any operation associated therewith was effected; or

B (b) that transfer and any operations associated therewith were bona fide commercial transactions and not designed for the purpose of avoiding liability to taxation.

C (6) Whether the income and gains sought to be imputed to Mrs. Willoughby under s 739 are exempted from taxation in the United Kingdom by Article 3(2) of the Double Taxation Arrangement between the United Kingdom and the Isle of Man on 29 July 1955 (1955 S.I. No.1205) as being the "industrial or commercial profits of a Manx enterprise".

D 4. Mrs Willoughby was represented by Mr. Robert Carnwath Q.C. and Mr. Philip Baker. The Commissioners of Inland Revenue were represented by Mr. S.J. Tabbush of the Solicitor's Office, Inland Revenue.

E 5. Oral evidence was given on behalf of Mrs Willoughby by Professor Willoughby and Mr. David Thomas Wilkie who until 1987 was a director of Personal Financial Consultants Ltd. and has since that date been a director of Matheson PFC Ltd.

F 6. In order to save repetition I repeat herein substituting Mrs. Willoughby for Professor Willoughby where the context requires paras 6 to 9 of the Case I have stated for the opinion of the High Court at the request of the Commissioners of Inland Revenue concerning Professor Willoughby and substituting for the second sentence in para 7 thereof "It forms part of this case but it is not annexed hereto since it is annexed to the said Case I have stated concerning Professor Willoughby". I decided the first and fifth issues in the negative in favour of Mrs Willoughby and the second, third, fourth and sixth issues in favour of the Crown.

H 7. The questions of law for the opinion of the Court are:—

(a) whether I erred in answering in the negative the first question in issue set out in para 3 above and

I (b) whether there was no evidence upon which I could answer in the negative the fifth question in issue as aforesaid.

For the purposes of para 2 of the Revenue Appeals Order 1987 I certify that my decision involves a point of law relating wholly or mainly to the construction of an enactment which has been fully argued before me and fully considered by me.

D. A. Shirley

 } Commissioner for the Special
 } Purposes of the Income Tax
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 15-19 Bedford Avenue
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31 August 1993

Professor P. G. Willoughby and Mrs. R. M. Willoughby

DECISION

1(a) Professor Willoughby appeals against assessments to income tax for the years 1987-88 to 1990-91 inclusive. Mrs Willoughby appeals against assessments to income tax for the year 1986-87 and the year 1990-91. It is agreed between the parties that the assessment on Mrs Willoughby for 1986-87 should be discharged. I am satisfied that that should be so.

(b) Professor Willoughby also appeals against the Board's rejection of his claim for relief under s 788 Income and Corporation Taxes Act 1988 ("the Taxes Act") and Article 3(2) of the Arrangement Scheduled to the Double Taxation Relief (Taxes on Income) (Isle of Man) Order 1955 (1955 S.I. No. 1205) for the years 1988-89, 1989-90 and 1990-91.

2. The income which forms the subject matter of the assessments is charged to tax under the provisions of Chapter III (Transfer of Assets Abroad) of Part XVII (Tax Avoidance) of the Taxes Act and in particular the first section of that Chapter; s 739, for the years 1988-89 onwards. The income for 1987-88 technically is charged under the earlier Taxes Act, 1970, s 478, the predecessor of s 739 and the successor to s 412 Income Tax Act 1952 which in its turn replaced the original enactment in s 18 Finance Act 1936. For present purposes no distinction is drawn between the guise in which the charging provisions appear at any time. I shall refer to the Taxes Act throughout this decision except where the context otherwise requires.

3. The issues which arise are as follows:—

(1) Whether s 739 ("Prevention of avoidance of income tax") can apply to a transfer of assets made by a transferor at any time when he was not ordinarily resident in the United Kingdom.

(2) Whether s 739 can apply to a transfer of assets situated outside the United Kingdom made by a transferor at a time when he was ordinarily resident in the United Kingdom.

(3) Whether s 739 can apply to the income arising under a policy of life insurance to which the provisions of ss 539 to 554 of the Taxes Act are applicable.

(4) Whether the deferral of a liability to United Kingdom income tax can constitute the avoidance of liability to income tax for the purposes of s 739.

(5) Whether on the facts as found:

A (a) the purpose of avoiding liability to taxation was the purpose or one of the purposes for which the transfer of assets to Royal Life Insurance International Ltd. or any operation associated therewith was effected; or

B (b) that transfer and any operations associated therewith were bona fide commercial transactions and not designed for the purpose of avoiding liability to taxation.

C (6) Whether the income and gains sought to be imputed to Professor and Mrs Willoughby under s 739 are exempted from taxation in the United Kingdom by Article 3(2) of the Double Taxation Arrangement between the United Kingdom and the Isle of Man on 29 July 1955 (1955 S.I. No. 1205) as being the "industrial or commercial profits of a Manx enterprise".

D 4. The Appellants were represented by Mr. Robert Carnwath Q.C. and Mr. Philip Baker. The Inspector of Taxes was represented by Mr. S. J. Tabbush of the Solicitor's Office, Inland Revenue. Mr. Carnwath and Mr. Tabbush very helpfully provided respectively a Skeleton and a Note of Argument.

E 5. Oral evidence was given by Professor Willoughby and on his behalf by Mr. David Thomas Wilkie. No oral evidence was led on behalf of the Crown.

6. The documentary evidence consists of

(a) An agreed statement of facts

F (b) Two bundles of documents to which I shall refer as Vol. 1 and Vol. 2 respectively. I need not itemise the contents here. Both contain an index .

7. Facts

G (1) Professor Peter Willoughby was born in 1937 in the United Kingdom. Mrs Ruth Willoughby was born in 1936 in the United Kingdom. Professor Willoughby is a solicitor and was until 1986 professor of law at the University of Hong Kong. Following his retirement from the University of Hong Kong, Professor Willoughby became a partner with the solicitors' firm of Turner Kenneth Brown, a position which he held until April 1992. Mrs. Willoughby is a retired solicitor.

H (2) Professor and Mrs. Willoughby have both spent much of their working lives in employment outside the United Kingdom. From 1962 to 1966 they were resident in parts of Africa. In 1973 they became resident in Hong Kong. Mrs Willoughby returned to England and became ordinarily resident in the United Kingdom on 13 August 1986. Professor Willoughby returned to England and became ordinarily resident in the United Kingdom in May 1987. Prior to their return, they were each ordinarily resident outside the United Kingdom. On 14 May 1992 Professor and Mrs. Willoughby left the United Kingdom and became resident in Alderney.

I (3) Professor Willoughby is a well-known expert in the field of revenue law, particularly the revenue law of Hong Kong. He is the author of the leading three-volume work on Hong Kong Inland Revenue Law, and is a

member of the Board of Review under the Hong Kong Inland Revenue Ordinance (a body equivalent in status to the combined Special and General Commissioners in the United Kingdom). He was until 1992 a member of the Revenue Law Committee of the English Law Society, and of the VAT Subcommittee of that Committee. He is chairman of the Hong Kong Joint Liaison Committee on Taxation, which brings together representatives of the Inland Revenue of Hong Kong and professional advisers in the taxation field. At the University of Hong Kong, Professor Willoughby lectured on general legal subjects such as land law and company law besides tax law. He was a member of the Law Reform Committee and of the Securities Commission in Hong Kong. He now spends about five months of each year in Hong Kong where he is a visiting professor and a consultant to a large firm of lawyers.

(4) During most of their working lives Professor and Mrs. Willoughby have been in non-pensionable employment. They have had to make and have made their own provision for retirement. At the University of Hong Kong there was a university superannuation fund of which Professor Willoughby was a member, and to which, whilst he was employed by the university, he duly contributed out of his income subject to Hong Kong taxation, but it was not going to provide him with adequate resources for his retirement. So in 1978 he consulted Personal Financial Consultants Ltd. ("PFC") which offers a variety of financial and investment services. As a result Professor and Mrs Willoughby entered into a Save and Prosper International Ten Plus Flexible Policy with Save and Prosper International Insurance Ltd. of Bermuda, commencing on 14 February 1979. They effected a similar policy commencing on 14 February 1981 and another on 14 January 1982.

(5) Each of the Save and Prosper policies were certified by the Commissioners of Inland Revenue under para 1(1)(a) Sch 2 Finance Act 1975 as a "qualifying policy". The premia were payable monthly and the policies matured at the expiration of ten years from their inception. Two of the policies were linked to shares in an open-ended company named Save and Prosper Jardine Far Eastern Fund S.A and the third (1981) was linked to Save and Prosper International Growth Fund Ltd. The obligation of Save and Prosper International Insurance Ltd. in Condition 2 was to credit the "share fund" with each premium and an amount equal to any distribution received by it in respect of shares in the share fund being a separately identified account maintained by Save and Prosper International Insurance Ltd., for the purpose of calculating benefits due to the persons assured under the policy and to which cash and shares are credited and debited under Condition 2. Condition 8 enables the assured within one month of maturity to extend the period of maturity by ten years paying a further premium each month during the extended period. The benefits assured on maturity date are the value of the share fund less a tax deduction payable in cash or by transfer of the number of shares in the share fund.

(6) On 17 November 1983 the Inland Revenue published a Press Release entitled "Offshore and Overseas Funds; Life Assurance Policies Issued by Non-Resident Life Offices". This followed upon the Answer given on that date by the Financial Secretary to the Treasury to a written Parliamentary Question seeking details of proposed legislation.

The question put to the Chancellor of the Exchequer was

"what will be the details of his proposed legislation for taxing disposals of holdings in offshore and overseas funds, and whether, in

A addition to proposing legislation on investments in such funds, he intends to change the tax treatment of life assurance policies issued by non-resident life offices to UK residents.”

The Answer reads as follows:—

B “I have authorised the Inland Revenue to issue today a statement giving the details of the new provisions for investments in offshore and overseas funds and of changes we intend to introduce in the tax rules for life assurance policies issued by non-resident life offices.

C The overall shape of the new provisions relating to the funds will be as follows:—

(i) they will apply to disposals after 1 January 1984 of interests in funds held by investors resident or ordinarily resident in the United Kingdom;

D (ii) they will apply to all funds not resident in the United Kingdom, irrespective of the type of investment they undertake—they will not be confined to specific types of fund such as money funds;

E (iii) the new rules will not apply where it is established that a fund genuinely distributes all its income. For this purpose funds will be able to obtain regular clearance as ‘distributors’ from the Inland Revenue;

(iv) except for any gain accruing before 1 January 1984, the whole of the investor’s gain on disposal will be taxed as income;

F (v) as at present, the capital gains regime will apply to gains accruing before 1 January 1984: the new rules will not apply retrospectively to such gains.

As regards life assurance policies issued by non-resident life offices to UK residents, there are a number of anomalies in the present rules. We propose to make the following changes in their tax treatment:—

G (i) policies issued in respect of insurances made after midnight tonight will not satisfy the qualifying conditions unless issued or administered in the course of UK branch business.

(ii) UK residents will be liable to income tax in full on their profits from non-qualifying policies issued after midnight tonight.

H The provisions will also apply to existing policies in certain circumstances; but special measures will be taken to safeguard the bona fide expatriate business of non-resident life companies. Fuller details are given in the Inland Revenue statement.

I It is proposed to legislate in the 1984 Finance Bill; Draft Clauses will be published in due course.”

Professor Willoughby saw the Press Release. It caused him concern, so much so that he wrote to the Financial Secretary. With his Save and Prosper policies in mind, it seemed from para (iv) and the reference in the second para (ii) to “profits” that all permitted withdrawals during the currency of a policy would be charged to tax at the full rates. His Save and Prosper policies would be charged to tax under the proposed regime. In 1983–84

Professor Willoughby was not alive to the provisions of s 478 Taxes Act 1970 which is not mentioned in any part of the Press Release nor was it referred to by the Financial Secretary in his reply to Professor Willoughby's letter. The new legislation was enacted in 1984 (and is now contained in ss 539-554 of the Taxes Act).

(7) In 1985 Professor Willoughby decided to take early retirement from the University and in July of that year he gave one year's notice accordingly. He was to receive on retirement a lump sum payment from the University's provident fund and he sought advice from PFC. He saw Mr. Glover, the managing director, and Mr. David Wilkie who was another director. He wanted something in the nature of a formal arrangement for a pension. The Save and Prosper arrangements were all right but they were not equivalent to a pension. Ideally he would have liked a deferred pension approved by the Revenue under s 226 of Taxes Act 1970, but he did not qualify for such a pension. In 1986 he was aged 49. He intended to return to live in the UK. He had a job lined up with Turner Kenneth Brown in London. He was retaining contacts in Hong Kong. He had a useful earning capacity and did not need income from his overseas savings in the University provident fund. He wanted to lock up his retirement payment from the University fund. His sole concern was to provide for his ultimate retirement and to have an arrangement which was flexible and also simple for his wife to deal with in the event of his death. Avoiding UK tax was not in his mind. He rejected a suggestion from a third party that he should adopt a scheme under which it was said no tax would ever be payable. He knew about the new taxation provisions introduced by Finance Act 1984.

PFC suggested that he put his money into a single premium bond taken out with Royal Life Insurance International Ltd. ("Royal Life"). Such a bond he was advised had the merit of flexibility in that the investments to which it was linked could be changed. Professor Willoughby adopted the proposed course of action.

(8) In 1984 PFC had prepared a pamphlet entitled

"The Single Premium Bond The Offshore and Onshore Versions".

The notes were written as a guideline to the then current position following the enactment of Finance Act 1984 as PFC understood it. They reflect the advice given orally to Professor Willoughby. Messrs. Glover and Wilkie were the authors of the pamphlet. Paragraphs 1 to 3 and para 6 read as follows:—

"1. INTRODUCTION

1.1 The Single Premium Bond was originally designed to take advantage of the tax concessions given to the U.K. life assurance industry in the sweeping changes of the 1974 Finance Act. Since then, there have been many alterations, and in the early 1970's some of the more adventurous international life assurance companies set up 'off-shore' Bonds investing in 'off-shore' unit trusts but still retaining the in-built U.K. tax advantages for the returning investor.

1.2 The Bond is a lump sum life assurance policy where the underlying investment is in a unit trust or a range of unit trusts.

A 1.3 The Bond is principally of use to the expatriate who intends to return to the United Kingdom.

B 2. GENERAL

B 2.1 Control

The Bond can be written on a single-life or on a joint-life, last survivor basis. The contract may also be assigned.

C 2.2 Flexibility

The Bond may be encashed at any time or partial surrenders made from time to time. The Bond does not have to be held for a specific number of years, although it must be stressed that the benefits are greater, as a general rule, the longer the bond is held.

D 2.3 Withdrawals

E Bonds automatically re-invest all dividends and yields from the underlying investments. Regular withdrawals can be made to provide income, and, as part of each withdrawal is treated as a return of capital, the level of taxation on regular withdrawals is substantially reduced, if not eliminated. The level of withdrawals, expressed as a percentage of the initial investment, may be varied to meet the specific needs of the investor.

F 2.4 Investment Policy

G The investment of each Bond may be spread over a number of funds giving a sound and secure spread of international investments. These are managed by well proven, long established management houses, and can be arranged to produce capital growth and/or income in the form of regular withdrawals. The investor does not have to leave his assets in the spread of funds selected at the time of taking out a Bond. The facility exists for him to change the investment emphasis by switching from one fund to another to take advantage of changing investment trends and to meet personal requirements. The selected investments are dominated in U.S. dollars or Sterling, although the underlying assets are invested in a spread of currencies, depending on the fund selected.

H 2.5 Life Assurance

I The contract provides for a death benefit, linked to the value of the underlying assets.

3. DESCRIPTION OF TAXATION AND INVESTMENT CONSIDERATIONS

This is where it is necessary to distinguish between 'off-shore' and 'on-shore' Bonds:

	On-Shore	Off-Shore	A
3.1 Tax			
a. Design	U.K. registered life office using U.K. registered unit trusts.	Tax haven (Jersey, Bermuda, etc.) registered life office using off-shore unit trusts.	
b. Corporate Tax	Both the life company and unit trust pay U.K. tax on income, though at reduced rates.	No U.K. tax liability	B
c. Tax on Proceeds for U.K. resident	<p>i. The initial investment can be withdrawn over 20 years with no tax liability i.e. 5% per annum tax free for 20 years.</p> <p>ii. Any additional withdrawals are only subject to higher rate tax when added on to the individual's taxable income in the year of withdrawal.</p> <p>iii. Final surrender - overall profit 'top-sliced' and liable only to higher rate tax levels in year of surrender, if applicable.</p>	<p>i. Same as On-shore Bonds.</p> <p>ii Additional withdrawals are subject to standard rate income tax plus the higher rate if applicable, with a proportionate reduction based on the number of complete policy years spent by the policy-holder outside the U.K.</p> <p>iii Final surrender - overall profit 'top-sliced' and liable to standard and higher rate tax in year of surrender, with the same proportionate reduction in respect of policy years spent overseas. (N.B. Pre-November 1983 Bonds have the same treatment as on-shore Bonds.)</p>	C D E
3.2 Investment Implications	Governed by performance of U.K. unit trusts - enormous choice covering every market sector ranging from ultra-conservative to highly specialised and hence more speculative.	Dependent on performance of off-shore funds, but it should be noted that there is a considerable advantage with fixed interest, deposit, bond and gilt funds for tax-free 'roll-up' within the funds for tax-free 'roll-up' within the funds. No standard rate tax relief. No tax if not drawn in the U.K. Potential gain if held whilst abroad and 'money funds' - see above - are used.	F G

...

6. CONCLUSION AND SUMMARY

The Bond has been designed to provide a tax efficient, flexible and easily controlled form of capital investment, and international results have proved this right. There are marginal extra costs over and above direct investment in unit trusts but set against a long term investment, these must be acceptable. The question for the expatriate of 'On-shore' v 'Off-shore' is easily balanced and depends on personal circumstances, but the latter still continue to provide an excellent long term accumulation investment vehicle for the secure range of deposit and bond funds."

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A (9) In July 1986 Professor and Mrs Willoughby jointly proposed for a private Portfolio Bond with Royal Life which is a company incorporated, managed and controlled and resident in the Isle of Man not having a permanent establishment in the UK within the terms of para 2(1)(k) of the Schedule to the Double Taxation Relief (Taxes on Income) (Isle of Man) Order 1955 (S.I. 1955 No. 1205).

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E On or before 8 August 1986, a time when neither Professor nor Mrs Willoughby were resident in the UK, Professor Willoughby paid out of moneys situated outside the UK a cash premium to Royal Life and 19 separate policies of insurance were issued on 8 August 1986. The policy of assurance occupies five lines. It was issued by Royal Life on the terms and conditions contained in the policy and the schedule issued therewith. There follow two pages of General Conditions and then a "Schedule to a Policy of Assurance issued by Royal Life Insurance International Ltd. on the Terms set out in its Standard Life Policy Form Number RL2 and in this Schedule." The Policy Number is 4371599. Fund No: 1121. Class of Assurance: Single Premium Bond. Professor Willoughby and Mrs Willoughby are respectively the Life Assured and the Second Life Assured. Their dates of birth are given. They are recorded as the Policy holders. The schedule goes on to record "A premium of US\$10,000.00 was paid, due 8 August 1986. Minimum Charge Rate US\$100.00 per annum. Review date 8 August 1994 [8 years later] No. of units allocated 10000.00 at a price of \$1.00 per Unit". Pages 25 to 41 contain identical schedules for policies numbered 4371600 to 4371616. The last schedule on page 42 for policy number 4371617 follows the same format, but the premium, minimum charge rate and number of units is geared to 11963.14.

F (10) I need not set out all the General Conditions. The policy is governed by Manx law. The Definitions in clause 1 indicate how the policy operates.

"General Conditions

Definitions

G 1. (1) 'The Company' means Royal Life Insurance International Limited.

H (2) 'The Fund' means each and any of the Funds specified in the Schedule forming part of the Policy which are separately identified accounts maintained by the Company solely for the purpose of calculating benefits under this Policy and certain other Policies issued by the Company.

I (3) 'Units' means the units into which the Fund is divided representing proportionate shares of the investments of the Fund. The number of Units for the time being need not correspond precisely with the number of Units allocated to Policies for the purpose of determining benefits payable. The number of Units in the Fund may at any time at the discretion of the Company be divided or consolidated into a greater or lesser number of Units as the case may be. In such event the number of Units allocated to the Policy at the date on which the division or consolidation is made will be increased or decreased as the case may be. The allocation of Units is purely notional and reference to Units is made solely for the purpose of computing benefits under the Policy.

(4) 'The Life Assured' means the person named in the Schedule to this Policy as the Life Assured, or the survivor of them where more than one Life Assured is named.

(5) 'Policy Value' means the value of the Units (calculated at the Bid Price) standing to the credit of the Policy less the amount of any premium due but unpaid."

Clause 8 deals with the valuation of the Fund and provides that there shall be credited to the Fund all amounts arising from the investment thereof. Then follows a list of items that might be debited to the Fund. Quoted securities are valued at middle market prices. Clauses 9 and 10 provide for death benefit and surrenders respectively.

"Death Benefit

9. On the death of the Life Assured (or, if two Lives Assured are named in the Schedule, that of the longer surviving of them) the amount payable will be the Policy Value on the next valuation date following the date when all the assets of the Fund have been realised for cash.

Surrenders

10. After first giving such prior written notice as the Company may from time to time require, the Policyholder may elect to surrender the Policy whereupon a cash sum will be paid equal to the Policy Value at the date of the valuation of the Fund, less a charge of half the Minimum Charge Rate applied to the period, if any, from the date of surrender to the Review Date."

Clause 12(a) states that "The allocation of Units is purely notional and reference to Units is made solely for the purpose of computing benefits under the Policy".

(11) The premium paid to Royal Life under Bond Number 1121 was invested and has remained invested in unit trusts and other investments held by Royal Life within the Fund to which the Bond was linked. In their proposal form dated 21 July 1986 Professor and Mrs Willoughby requested the appointment of PFC as Fund Advisers to the Fund to which the policies were to be linked. They also authorised PFC to make the initial choice of Funds and to exercise any of the options for switching between Funds relevant to the Royal Life policies they had effected. PFC were to have the same investment powers to exercise options for switching between Funds as if they were the Policyholder. These powers have been exercised. With the exception of one investment the original investments have been changed. The exception is Personal Financial Consultants International Portfolio Balanced Growth Fund the holding in which increased between 30 September 1986 and 28 March 1991. This fund is a "distributing fund" within s 760, Taxes Act.

(12) A Royal Life policy appealed to Professor Willoughby as he considered that it provided him with something like a s 226 retirement annuity in that he could make annual withdrawals free of tax within limits, the withdrawals resembling an annuity, but unlike an annuity capable of being timed, a feature which is not unique to Royal Life bonds. Professor Willoughby was concerned about the tax charging provisions under Finance Act 1984 (now s 539 et seq Taxes Act) but he decided to accept them and forgo the capital gains tax reliefs to which he would have been entitled on

A realisation of investments held by himself. It was his understanding also that the expense or the charges levied by Royal Life were less than those charged by a stockbroker or by PFC for managing his investments.

B In this he was right but it emerged in cross examination of Mr. Wilkie that the difference may not have been as much as he had supposed. If that be the case I find that Professor Willoughby was not aware of it at any material time. He knew that there were no "front end charges" of 5 per cent. which he would have had to pay had he himself bought units in investment trusts. In this way the policy was 5 per cent. more valuable to him than a direct investment would be. There was a strong disincentive to procure the surrender of the policy within eight years of effecting it since there would be an appreciable charge for doing so (which though dated November 1988 I infer from the evidence was applicable in 1986).

D (13) In 1989 the first of the three Save and Prosper Ten Plus policies (the 1979 policy) was due to mature. By this time Professor and Mrs Willoughby were ordinarily resident in the UK with every intention of remaining there permanently.

On 1 February 1989 Matheson PFC (London) Ltd. (a fellow company of PFC which by this date had become part of the Jardine Matheson Group), wrote to Professor Willoughby as follows:—

E "On maturity of your Save and Prosper 10+ Policy No. RPP/100092 there are three options which are worthy of consideration:

F 1. Convert into a UK whole life contract which would provide you with income free from personal tax liability in the future. However, the underlying funds in which the investment would be held would have to be Save & Prosper's standard UK range and all of these would be taxed on income received as well as capital gains. The growth would, therefore, be substantially less than an equivalent fund which was not taxed. As you do not intend to start drawing an income for several years it would seem to be important to get the gross roll-up.

G 2. Convert the policy into an offshore whole life policy which would provide gross roll-up on the underlying funds but the income, when taken, would be liable to personal tax at both basic and higher rates. The investment funds which would be available to you under these circumstances would be Save & Prosper's offshore funds, IPF and some of the Jardine Fleming offshore funds. The 5 per cent. per annum withdrawal, free from tax liability would apply.

H 3. Take the tax-free proceeds and invest in an offshore Personal Portfolio Bond. This would provide gross roll-up in the investment fund selected and there is virtually no restriction on what investment may be selected, including building society and bank deposits, gilts and equities. There is total flexibility to be able to switch between all these investments as thought necessary. The 5% p.a. tax-free withdrawal facility is available but on final surrender the gain is subject to basic and higher rate tax if applicable at that time. Using this reinvestment vehicle would enable the bond to be written on your joint lives but to be owned by your wife, which means that any amount withdrawn in excess of 5% would be regarded as taxable income in her hands and could be set off against her own Personal Allowance which will apply as from April 1990. This would be a tax efficient thing to do.

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The maturity date is the 13th March but Save & Prosper need to receive your instructions by about the middle of February. Please let me know your decision before then so that I can help you with any arrangements which are necessary.”

(14) There was no tax difference between option 2 and option 3. Option 2 arises under the Save and Prosper Ten Plus policies themselves. Professor Willoughby opted for option 3 and another Personal Portfolio Bond with Royal Life since it provided more flexibility and “it was all under one roof”. He did not select option 3 for the purpose of avoiding UK tax. If he had appreciated any serious risk from the application of s 739 he would have selected option 2. A further possibility would have been to exercise the option in condition 8 of the Save & Prosper policy to extend the period of maturity by ten years.

(15) Mrs Willoughby proposed for the second Royal Life Bond in February 1989. The proceeds of the first (1979) Save & Prosper policy which consisted of units in a unit trust not situated in the UK (Personal Financial Consultants International Portfolio Balanced Growth Fund) were transferred to Royal Life as payment of the premium on the Bond. On 13 March 1989 six policies were issued under Bond Number 2387. Royal Life retained those units together with cash on general transaction account as the Fund to which the Bond was linked. The formal parts of the Policies and the schedules thereto are similar to but not quite the same as those in Bond Number 1121. Nothing turns on the differences.

(16) In February 1990 Mrs Willoughby proposed for the third Royal Life Bond. The two remaining Save and Prosper Ten Plus policies were surrendered and the proceeds in the form of units in the same unit trust, Personal Financial Consultants International Portfolio Balanced Growth Fund, were transferred to Royal Life as payment of a premium on the Bond. On 30 March 1990 nine policies were issued under Bond Number 3343. Again the formal parts are similar to but not the same as those in Bond No 1121. In the case of Bond No 2387 and Bond No 3343 Mrs Willoughby is the life assured and Professor Willoughby is the second life assured.

(17) On 17 August 1990 three further policies were issued to Professor and Mrs Willoughby under Bond No 1121. The premium for these policies was paid in the form of the transfer of units in a unit trust not situated in the UK (Person Financial Consultants International Portfolio Balanced Growth Fund). These units were then sold within the Bond by Royal Life to meet administrative charges on General Transactions Account.

(18) (a) There are in evidence brochures issued by Royal Life giving details about Private Portfolio Bonds. Professor Willoughby was provided with a brochure by PFC after he had signed the proposal forms in 1986. It played no part in his decision to invest in Bond Number 1121. He relied on the advice he received from PFC. The brochures current in 1989 and 1990 played no greater part since at that time he had the advice of Matheson PFC (London) Ltd. The earliest brochure containing any reference to s 739 is dated June 1990.

(b) PFC have many clients investing in these bonds the majority of whom retire in Hong Kong. They are useful where an individual receives a lump sum on retirement. They are appropriate for residents in the European

A Community and Australia. Their favourable tax treatment is an attraction. Administratively they are convenient for an individual since Royal Life does all the work. Royal Life is an efficient company and it is backed by a strong parent company in the UK.

B (19) It is an agreed fact that the effect of the arrangements was that the income arising in respect of the three Bonds during the years of assessment in issue was (apart from the operation of s 739 and its predecessor) free of UK income tax until such time as the respective insurance policies matured or were surrendered in such a way as to enable Professor or Mrs Willoughby to receive sums equal to the value of the contents of the Fund. At that point, the gain arising in connection with the policies would be chargeable in accordance with s 541(1) of the Taxes Act (or its predecessor). Income has arisen in each of the three funds; gains have arisen in the Fund for Bond number 1121. It is unnecessary to record here the amounts.

D (20) On 18 March 1991 Professor Willoughby wrote to the Special Investigations Section of Inland Revenue informing them of the three Bonds. Notices of assessment under s 478 of Taxes Act 1970 and s 739 of the Taxes Act 1988 were issued as indicated in para 1 above.

E (21) It is accepted by the Revenue that all of Professor Willoughby's investment savings held in the Funds were earned abroad and have never been transferred from the UK to a non resident (letter dated 8 August 1991).

(22) Professor Willoughby's removal to Alderney in 1992, along with Mrs Willoughby, represents a complete change of plan.

F 8. Statutory provisions.

Section 739.

G "739.—(1) Subject to section 747(4)(b), the following provisions of this section shall have effect for the purpose of preventing the avoiding by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfers of assets by virtue or in consequence of which, either alone or in conjunction with associated operations, income becomes payable to persons resident or domiciled outside the United Kingdom.

H (2) Where by virtue or in consequence of any such transfer, either alone or in conjunction with associated operations, such an individual has, within the meaning of this section, power to enjoy, whether forthwith or in the future, any income of a person resident or domiciled outside the United Kingdom which, if it were income of that individual received by him in the United Kingdom, would be chargeable to income tax by deduction or otherwise, that income shall, whether it would or would not have been chargeable to income tax apart from the provisions of this section, be deemed to be income of that individual for all purposes of the Income Tax Acts."

I I need not read the remaining subsections. Subsection (1) contains what used to be called "the preamble" to s 478 of the Taxes Act 1970 and the earlier legislation. Section 740 is not relevant. Section 741 reads as follows:—

“741. Sections 739 and 740 shall not apply if the individual shows in writing or otherwise to the satisfaction of the Board either—

(a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected; or

(b) that the transfer and any associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation.

The jurisdiction of the Special Commissioners on any appeal shall include jurisdiction to review any relevant decision taken by the Board in exercise of their functions under this section.”

No question arises on s 742 (Interpretation of ss 739–741).

9. The first issue.

This concerns only the first transaction. The transfers of assets in respect of the 19 policies issued under Bond Number 1121 were made on or before 8 August 1986 when neither Professor Willoughby nor Mrs Willoughby were ordinarily resident in the UK.

Mr. Carnwarth submits that subs (1) on a literal reading restricts the operation of s 739 to transfers of assets made by individuals who are ordinarily resident in the UK at the time they make the transfers. This follows from the decision of the House of Lords in *Vestey v. Commissioners of Inland Revenue* (1979) 54 TC 503; [1980] AC 1148.

In that case two settlors who were ordinarily resident in the UK conveyed in 1942 valuable property outside the UK to trustees resident outside the UK to hold upon discretionary trusts for a number of beneficiaries to some of whom capital payments were made in the 1960s. The recipients were charged to income tax under s 412 Income Tax Act 1952. The settlors were not so charged since they received nothing nor had they any right to receive any sum. It was held by the House of Lords that s 412 only applied to an individual who made, or, maybe was associated with, the transfer. In so doing the House reversed its own decision in *Congreve v. Commissioners of Inland Revenue* 30 TC 163 the ratio of which was that Mrs Congreve could be taxed under s 18 Finance Act 36 (the predecessor of s 412) in respect of assets transferred by her father, thereby interpreting the section in a wide manner.

For the Crown it is submitted that notwithstanding the decision in *Vestey* the decision of the Court of Appeal in Northern Ireland in *Herdman v. Commissioners of Inland Revenue* 45 TC 394; [1969] 1 WLR 323 is still good law. In that case, Herdman being ordinarily resident in the Republic of Ireland transferred shares in a Northern Irish company to a company resident in the Republic in which he held shares. Herdman later became ordinarily resident in the UK. It was found as a fact that the transfer itself came within the statutory defence to s 412 (no tax avoidance). The Court of Appeal rejected (as did the Special Commissioners) the contention that s 412 did not apply because Herdman was not ordinarily resident in the UK at the time of the transfer. Herdman succeeded on another point and that was the

A only point considered in Crown's appeal to the House of Lords. There was no cross appeal by Herdman.

In order that the instant issue can be properly appreciated I should cite at some length the judgment of Lord MacDermott C.J. 45 TC 394, at pages 403-5.

B "This concession recognises the width of meaning given to these
C words 'power to enjoy' by subs (5), and brings us at once to the first
D proposition submitted by Mr. Potter on behalf of the Appellant, namely,
that the words 'such an individual' must relate to the words of the
preamble '... by individuals ordinarily resident in the United Kingdom'
and must therefore connote an individual who is so resident at the time
of the scheme for tax avoidance, which I take to mean at the time of the
transfer of assets and such associated operations as may have to be
regarded in conjunction therewith. If this is the true meaning of the
subsection then, the argument proceeded, the Appellant was not within
it, as he was not ordinarily resident in the United Kingdom at the time
of the transfer or at any material time. The Attorney-General, for the
Crown, vigorously disputed this construction of the subsection, and
submitted that the words 'ordinarily resident in the United Kingdom'
simply referred to the year of charge.

E This point does not seem to have been the subject of decision, but
there are passages in some of the reported cases which, at any rate at
first sight, appear to lend support to Mr. Potter's contention. Thus, in
MacDonald v. Commissioners of Inland Revenue 23 TC 449, at page 456,
Macnaghten J. (speaking of the similar wording of s 18 of the Finance
Act 1936) says:

F '... the section has no application to any transfer of assets
unless ... it is a transfer made by an individual ordinarily resident
in the United Kingdom ...'

And, again, in *Vestey's Executors v. Commissioners of Inland
Revenue* (1949) 31 TC 1, at page 116, Lord Reid observes:

G 'Section 18 applies if individuals ordinarily resident in the
United Kingdom seek to avoid liability to Income Tax by
transferring assets so that income becomes payable to persons
resident out of the United Kingdom.'

H In my view such passages do not suffice to sustain Mr. Potter's
submission, and I have come to the conclusion that that of the Crown is
to be preferred. Macnaghten J. and Lord Reid were not directing their
observations to the point which has been raised before us, and their
paraphrase of the corresponding language of s 18 was not, I feel certain,
intended to settle any issue of construction. It is clear that the
"individual" of s 412 need not be the maker of the transfer or an active
I participant in the scheme for avoidance: see *Congreve v. Commissioners
of Inland Revenue* (1948) 30 TC 163, at pages 196-7, and at page 204,
where Lord Simonds says:

'The preamble or introductory words of the Section which state
its purpose do not, in my view, assist the contention, which was
developed upon its operative words, that the avoidance by an
individual of liability to tax must be achieved by means of a
transfer of assets effected by that individual. They are, on the

contrary, in the widest possible terms, and I do not know what better words could be used if the Legislature intended to define its purposes as covering a transfer of assets by A, by means of which B avoided liability to tax. When I turn to the operative words, I cannot reach any other conclusion. It was urged that in their context the words "by means of any such transfer" can mean only a transfer effected by the individual who avoids tax liability. It was said that they do not mean the same as "as a result of" or "by virtue or in consequence of", and the immediate proximity of the latter phrase was referred to as pointing the contrast. My Lords, this is altogether too fine a distinction. The difference of the language is sufficiently explained by the wish of the draftsman not to use the same expression twice. But it is to my mind clear, first, that in their ordinary grammatical sense the words "by means of" do not connote any personal activity on the part of the person who is said to enjoy or suffer something by those means, and, secondly, that in their present context it is not necessary or legitimate in order to give a limiting sense to the words to read them as if they were followed by such words as "effected by him".

The individual, accordingly, at whom s 412 is aimed is the person who seeks to avoid liability to charge, irrespective of whether he was or was not a participant, in setting up the scheme for avoidance. This explains the reference to 'ordinarily resident in the United Kingdom', for that points to those who would gain by the avoidance rather than to those who may have contrived it—perhaps in some earlier year. There seems no reason why the section should make such residence necessary for those who play a part in the scheme for avoidance at the time they do so, and I do not think the language used provides for such a requirement. The section is drafted in comprehensive terms and there can be no doubt it was intended to cast a wide net.

That being the nature of the enactment, it would be surprising if Parliament had left such a large loophole open as would be the case if Mr. Potter's argument were well founded. Contrast, for example, the following instances. A, whose career abroad ends when he attains a certain age, decides to retire to the United Kingdom, and before his return from abroad transfers his United Kingdom assets to a company he has incorporated in the Irish Republic with a view to future tax avoidance. B, on the other hand, who has always been resident in the United Kingdom, does likewise for the same reason. Why should A be outside and B within s 412? Neither the wording of the section nor its underlying purpose seems to me to call for such an anomalous distinction. I would therefore hold against the Appellant on this branch of the case."

Mr. Tabbush relies on this judgment even though *Congreve* was later reversed. It is a specific decision that the transferor need not be resident in the UK when he makes the transfer of assets by virtue of which income becomes payable to persons resident outside the UK. That he should be ordinarily resident in the UK at the time of the transfer is not necessary: he must be resident in the UK when the income arises which would be his but for the transfer. Professor Willoughby is in exactly the same position as *Herdman* on this score. If he were not ordinarily resident in the UK when the income so arises he would not be taxable anyway.

A Although the House of Lords in *Vestey* did not consider the case where
a transfer is made by a non UK resident who later becomes resident, the
construction of s 412 adopted by their Lordships in my opinion points
towards a requirement that the transferor shall be ordinarily resident at the
time he makes the transfer. Lord Wilberforce says that s 412 has a limited
B effect particularly having regard to the preamble. He contrasts this with an
extended meaning (54 TC 503, at page 583 and page 584). Viscount Dilhorne
states at page 589:

C “Cohen L.J. [in *Congreve*] with whose judgment Lord Simonds
agreed on all points treated the words ‘such an individual’ in subss (1)
and (2) as meaning an individual ordinarily resident in the United
Kingdom. Their meaning does not appear to have been debated in the
House. A possible meaning appears to me an individual ordinarily
resident who has sought to avoid liability to income tax by means of a
transfer of assets abroad. If that was their meaning, then the scope of s
412 is limited. If, on the other hand, the words just mean an individual
ordinarily resident in the United Kingdom, the decision of this House in
D *Congreve v. Commissioners of Inland Revenue* 30 TC 163 was I think
right.”

That last sentence, it seems to me, is reflected in the Crown’s submission
in the instant appeal and was rejected by Viscount Dilhorne at page 591.
Lord Edmund-Davies at 54 TC 503, at page 601 holds that

E “... the words ‘such an individual’ appearing in subss (1) and (2)
[(2) & (3) of s 739] hark back to the opening words of the preamble
namely to individuals whose purpose is the avoidance of liability to tax,
and do *not* refer simply to any individual ‘ordinarily resident in the
United Kingdom’.”

F Finally Lord Keith of Kinkel says at 54 TC 503, at page 602:

G “I have arrived at the firm opinion that the principal ground of
decision in *Congreve* was indeed erroneous. I consider that the natural
and intended meaning of the words ‘such an individual’ in s 412(1) is
that they indicate not merely an individual ordinarily resident in the
United Kingdom, but an individual so resident who has sought to avoid
liability to income tax by means of such transfers of assets as are
mentioned in the preamble.”

H In *Herdman’s* case Lord MacDermott relied wholly on Lord Simonds’
speech in *Congreve* and he cited the ratio decidendi of that speech. Following
Vestey, his statement cannot be right “that ‘the individual’ of section 412
need not be the maker of the transfer or an active participant in the scheme
for avoidance”. His conclusion was also erroneous that “the individual ...
at whom section 412 is aimed is the person who seeks to avoid liability to
charge [true], irrespective of whether he was or was not a participant in
setting up the scheme for avoidance [false].” “The section ... was intended to
I cast a wide net.” *Vestey*, per contra.

In my opinion it is unsafe to rely on this decision that Herdman was
within the scope of s 412 being resident in the Republic of Ireland as a guide
to the application of s 478 of the Taxes Act in relation to Professor
Willoughby and the 19 policies issued under Bond No 1121. The same may
be said of *Philippi v. Commissioners of Inland Revenue* ([1971] 1 WLR 1272)
47 TC 75 (see Lord Denning M.R. at page 111).

The result of the *Vestey* case as perceived by Whiteman on Income Tax 3rd Edn, 1988 at para 23-07 is that s 478

“only applies to individuals ordinarily resident in the UK who have sought to avoid income tax by the transfer of assets abroad, and who yet manage when resident in the UK to obtain or to be in a position to obtain benefits from those assets.” Implicit in this formulation of the result of *Vestey* is that the section “will only come into play where the transferor was ordinarily resident in the UK at the time of the transfer of assets in question”.

The facts in the instant appeal with regard to Bond No 1121 are not the same as in *Vestey's* case since there the settlors who made the transfer were ordinarily resident in the UK. But if the preferred construction of the preamble to the legislation (now s 739(1) of the Taxes Act) is the narrower one of the two possible constructions in my opinion it follows that my decision should be, as I hold, that s 739 does not apply to an individual who is not resident in the UK when he makes the transfer.

Any lingering doubt there may be on this topic is put to rest if one reads the two following statements of the then Financial Secretary to the Treasury, Mr. W.S. Morrison, in the debates on the Finance Bill, which became Finance Act 1936, in the House of Commons on 15 June 1936 and 1 July 1936.

Having described the clause (which became s 18 Finance Act 1936) as being “of a very restricted nature”, the Financial Secretary said:

“Under the Clause for the purpose of treating a man’s income in an exceptional manner, there have to be three conditions present. In the first place, there has to be a transfer of assets abroad by an individual resident in this country. Secondly, that transfer must have given rise to rights in the individual who makes it. Thirdly, the individual must have power to enjoy the income of the foreign company. It is not until these three conditions are present that the Clause comes into operation.” (H C Deb. Vol 313 Col. 685)

His second statement reads as follows:—

“[The hon. and leaned friend] asked us to imagine the case of a foreigner ordinarily resident here who has transferred foreign securities to a foreign company. If the foreigner made that transfer in the past, before he became ordinarily resident here, the Clause would not apply to him, because in its opening words it refers to: ‘individuals ordinarily resident in the United Kingdom’.” (H C Deb. Vol 314 Col. 435)

I cite these passages following the guidance of the House of Lords in *Pepper v. Hart* [1993] AC 593; 65 TC 421; [1992] 3 WLR 1032, at page 1061 per Lord Browne-Wilkinson.

10. *Second Issue*

Mr. Carnwath submits that s 739 is ambiguous as to whether the assets transferred must be situated in the UK at the time of the transfer. He cites dicta in three cases in support of the view that the section only applies to transfers of assets abroad that is, from the UK to overseas. The cases are *Vestey*, *Corbett's Executrices v. Commissioners of Inland Revenue* 25 TC 305

A and *Lord Chetwode v. Commissioners of Inland Revenue* [1977] STC 64. He prays in aid statements by the Financial Secretary, HC Deb. Vol 313 Cols. 678 and 685 and adopts as part of his argument the conclusion in Whiteman on Income Tax at para 23-08 that a transfer from one overseas territory to another will not suffice (citing passages from *Vestey* in para 23-09 to which Mr. Carnwath refers).

B However, reading s 739(1), the relevant words in my opinion leave this question open. The heading of Chapter III is "Transfer of Assets Abroad". This connotes primarily transfers from the UK, but I think not necessarily so. The material words in the section are, "avoiding by individuals resident in the UK of liability ... by means of transfers of assets by virtue ... of which income becomes payable to persons resident ... outside the UK."

C In my opinion, and I so hold, this language may be satisfied whether the assets are transferred from the UK to outside the UK or being outside the UK they are transferred to a person outside the UK.

D It is notable that in the *Vestey* case itself the assets transferred were foreign assets and Lord Wilberforce says of the transfer,

E "There is no doubt that this was a transfer of assets by virtue of which income became payable to persons resident out of the UK ... so as potentially to bring s 412 into operation" (54 TC 503 at page 576 which I have cited above).

F The Parliamentary Debates give no specific answer to this question which was in terms raised by Mr. Maxwell Fyfe (HC Deb. Vol 313 Cols. 726-7) but there is little doubt left in my mind from reading the Financial Secretary's statement in HC Deb. Vol 314 col. 435 that transfers of assets outside the UK to another person outside the UK would be within the scope of s 412.

G Mr. Carnwath concedes that it is difficult to interpret the dicta in the cited cases to which he referred as requiring that the assets must be physically removed out of the UK since that would raise problems with regard to the transfer of immovable property. He submits, however, that the object of s 739 is to prevent in the removal of assets out of the *UK tax net* (i.e. removing an asset presently subject to UK tax from that liability to tax). Section 739 accordingly has no application where assets which are not within the UK tax net to start with are transferred to a non-resident person.

H Ingenious though this submission may be, I am not persuaded by it. I can see no reason on the language of s 739 why an individual resident in the UK should be able to transfer, with immunity from the section, to a person resident outside the UK an overseas asset producing no income which then becomes income producing or is changed for an income producing asset. It may be said that the asset was never within the UK tax net, but in my view it is irrelevant that the asset transferred is non income producing at the time of the transfer if the object is to avoid UK income tax by means of the transfer.

11. *Third Issue*

This involves the interaction, if any, between s 739 and ss 539-554 ("the chargeable event provisions") which deal with, *inter alia*, the taxation of life policies including in particular offshore or non resident life insurance policies

the subject matter of the Inland Revenue Press Release of 1983. Can s 739 apply to the income arising under a policy to which the provisions of ss 539-554 are applicable?

Mr. Carnwath's submissions are as follows:—

(1) Section 739 applies where a person avoids liability to income tax by means of a transfer of assets.

(2) In this case no income tax is avoided. The gain arising in connection with a policy as computed under the statute will be treated as income and be taxed at the basic and higher rates on surrender or maturity. The policies are subject to the form of taxation deemed appropriate and enacted by Parliament for this specific type of transaction. This is not tax avoidance.

In support of this submission Mr. Carnwath cites *Commissioner of Inland Revenue v. Challenge Corporation Ltd.* [1986] STC 548; [1987] AC 155. This was an appeal to the Privy Council from the Court of Appeal in New Zealand. It concerned the tax avoidance provisions in s 99 of the Income Tax Act 1976 of New Zealand which provided that "Every [contract] ... shall be absolutely void as against the Commissioner for income tax purposes if ... its purposes or effect is tax avoidance", defined as including, *inter alia*, "directly or indirectly avoiding, reducing or postponing any liability to income tax".

At [1986] STC 548, at page 554 Lord Templeman says,

"The material distinction in the present case is between tax mitigation and tax avoidance ...

Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. Section 99 does not apply to tax mitigation because the taxpayer's tax advantage is not derived from an 'arrangement' but from the reduction of income which he accepts or the expenditure which he incurs.

Thus when a taxpayer executes a covenant and makes a payment under the covenant he reduces his income. If the covenant exceeds six years and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the payment under the covenant.

When a taxpayer makes a settlement, he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income.

Where a taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitled the taxpayer to reduction of tax liability. The tax advantage results from the expenditure on the premium.

A taxpayer may incur expense on export business or incur capital or other expenditure which by statute entitles the taxpayer

A to a reduction of his tax liability. The tax advantages result from the expenditure for which Parliament grants specific tax relief.

B When a member of a specified group of companies sustains a loss, s 191 allows the loss to reduce the assessable income of other members of the group. The tax advantage results from the loss sustained by one member of the group and suffered by the whole group.

Section 99 does not apply to tax mitigation where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability.

C Section 99 does apply to tax avoidance. Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.”

D (3) If the Revenue are right that both s 739 and ss 539–554 apply, Professor Willoughby would be taxed on income and gains as they arose and later under the chargeable events provisions. Double taxation is possible. This is acknowledged by the Revenue in correspondence of a letter dated 9 November 1990 from Inland Revenue to Royal Life. It is said that relief against double tax would be given but it is not clear how it would be given. In principle relief by concession is undesirable (see *Vestey*).

F Mr. Tabbush submits that s 739 is absolute in its terms and if the effect is that income is taxed as it arises under the section and the net increase in value of the policy is taxed on realisation under the chargeable events provisions that has to be endured. As to this he makes no admission and submits that the provisions in s 547(2) and s 743(4) provide relief.

G Mr. Tabbush contends that there is here “tax avoidance” within *Challenge Corporation* principles, not “tax mitigation” since the arrangement is indistinguishable from holding a normal portfolio, unlike the case where the taxpayer has “genuinely” deprived himself of something. In a normal policy a premium is invested in a pool of securities shared with all other policy holders. Professor Willoughby’s Bond Fund is invested in securities “unique to the policyholder” which he can change at will. Moreover, tax deferment constitutes tax avoidance *Furniss v. Dawson* 55 TC 324; [1984] AC 474 where a sale of shares by A to C took place by means of a transfer of those shares to B, a Manx company, in exchange for shares in B which then sold on the shares to C thereby (for reasons I need not rehearse) deferring the charge on A to capital gains tax to which A would have become liable in the absence of the interposed B. It was held that capital gains tax was nevertheless chargeable on A since the inserted step had no business purposes apart from the deferment of tax.

I The arguments addressed to me on this issue to some extent impinge on the fourth and fifth issues. So far as double taxation is concerned, in my view s 547(2) and s 743(4) do not provide relief. The former gives relief if the amount of the gain arising in connection with a policy on the happening of a chargeable event, which is deemed to form part of the individual’s total

income for the year in which the event happens, is chargeable to tax apart from subs (1) of s 547. This does not provide relief for the taxation of income under s 739 in the years before the chargeable event occurs. And s 743(4) only relieves from tax income which is subsequently received by an individual whose income it has been deemed to be in earlier years under s 739(2).

In my opinion there could very well be some double taxation in effect if s 739 were applied in respect of income arising to Royal Life during the life of a policy and the gain realised on surrender or maturity were taxed under s 539 et seq, since part of that gain is derived from such Income.

However I do not think that that consideration alone is sufficient to enable me to hold that s 739 cannot apply to the income of Royal Life from investments underpinning a policy to which the provisions of ss 539 to 554 apply. Even taking account of the fact that such relief from double taxation as may be given will be by concession I feel no more emboldened so to hold despite Walton J's aphorism that "one should be taxed by law, and not be untaxed by concession" (*Vestey* 54 TC 503, at page 544).

I will deal below with the submission that income tax has not been avoided by Professor Willoughby.

12. Fourth Issue

This is whether the deferment of liability to UK income tax can constitute the avoidance of liability to income tax for the purposes of s 739.

In the abstract this is a difficult question to answer. In the very first sentence of his speech in the House of Lords in *Furniss v. Dawson* Lord Brightman say, 55 TC 324, at page 393; [1984] AC 474, at page 518 "My Lords, the transaction which we are called upon to consider is not a tax avoidance scheme but a tax deferment scheme", thereby singling out a scheme whereby tax is deferred as distinct from one whereby tax is avoided. The fiscal defect in the scheme was the insertion of a step for which there was no commercial justification and the result was the same as it would have been without that step. In a true sense, however, but for that step tax to which A would otherwise have been liable on a sale of shares was then avoided.

I do not see why in principle the avoiding by individuals ... of liability to income tax by means of transfers of assets should not include the deferring by individuals of liability to income tax. I am not sure that this is a convincing concept, however, for how does one defer an annual income tax liability? It is more natural, and I would think in keeping with the statute, to consider whether what is done by means of a transfer of assets is not rather the avoiding of a current liability to income tax, non constat that at the end of the day when a policy is surrendered a 'deferred' (and different) liability to tax arises.

We are not in the realm of "unacceptable tax avoidance" where "structures are designed to achieve an adventitious tax benefit for the taxpayer and are in truth no more than raids on the public funds at the expense of the general body of taxpayers, and as such are unacceptable" *per* Lord Goff of Chieveley in *Ensign Tankers v. Stokes* [1992] STC 226 at page 244 who accepted that "there is a fundamental difference between tax

A mitigation and unacceptable tax avoidance". The enactment of s 739 or rather its ancestor s 18 Finance Act 1936 was prompted by the unacceptable want of civic sensibility on the part of those individuals ordinarily resident in the UK who transferred assets abroad for the purpose of avoiding liability to income tax whereby income became payable to persons resident outside the UK from which the individual transferor could benefit, enjoying the benefits of residence in the UK without sharing in the appropriate burden of British taxation (see Viscount Simon L.C. in *Latilla v. Commissioners of Inland Revenue* 25 TC 107 at page 117; [1943] AC 377).

Accordingly I hold that deferring liability to income tax can constitute the avoidance of liability to income tax for the purposes of s 739.

The question in any particular case is, does it? This question underlies the third issue and to my mind it is fundamental to the whole case. It is the fifth issue.

D 13. *Fifth Issue*

The statutory defence, s 741.

Of the four types of transaction noticed by Lord Templeman in *Challenge Corporation Ltd.* [1986] STC 548 at page 554, no transaction effected by Professor Willoughby and relevant to this appeal is (as I find) a sham nor one which effects the evasion of tax. For the Crown it is contended that the transactions avoid tax and for Professor Willoughby that they mitigate tax.

The Crown takes as its text the passage in Lord Templeman's speech [1986] STC 548, at page 555d.

"Section 99 does apply to tax avoidance. Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had."

The text for Professor Willoughby is contained in the preceding paragraph coupled with an illustration on the same page.

"Section 99 does not apply to tax mitigation where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability."

"Where the taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitles the taxpayer to reduction of tax liability. The tax advantage result from the expenditure on the premium."

I should cite two further paragraphs from Lord Templeman's speech which throws some light on the present problem. *Challenge* group sought to reduce its assessable income. It bought for \$10,000 a company which had sustained losses of \$5.8m. It attempted to set the losses against its profits. *Challenge* did not practise tax mitigation because the group never suffered

the loss of \$5.8m. The tax advantage stemmed from the purchase arrangement. It was argued that if the Commissioner's appeal succeeded a purchase of shares in a company which becomes part of a specified group will always be void under s 99. Lord Templeman commented that at [1986] STC 548, at page 555

"... a purchase of shares will only be void in so far as it leads to tax avoidance and not tax mitigation. In an arrangement of tax avoidance the financial position of the taxpayer is unaffected (save for the costs of devising and implementing the arrangement) and by the arrangement the taxpayer seeks to obtain a tax advantage without suffering that reduction in income, loss or expenditure which other taxpayers suffer and which Parliament intended to be suffered by any taxpayer qualifying for a reduction in his liability to tax."

In a letter dated 27 June 1991 to Professor Willoughby the Revenue write that

"we do not consider it to be tax avoidance in the meaning of section 739 merely because a taxpayer chooses to invest in a policy with an offshore company. We have looked at a large number of products offered by the offshore insurance industry but are only challenging certain highly personalised products of which the Royal Life Private Portfolio Bond is an example."

In a letter dated 8 August 1991, the Revenue tell Professor Willoughby that they understand from the Association of International Life Offices that policies of this nature represent only some two per cent. of the market. Section 739 is not being applied against the whole range of offshore life assurance policies. The Revenue has concentrated its attention "on the so-called personal portfolio bonds and similar products which confer on the policyholders rights to invest in a unique fund of assets and to choose assets not within a standard menu of pooled funds which unit-linked policies normally offer."

Now, the provisions of s 739 "have effect for the purpose of preventing the avoiding by individuals ... of liability to income tax by means of transfers of assets ..." The section does not apply if the individual shows "that the transfer and associated operations were bona fide commercial operations and were not designed for the purpose of avoiding liability to taxation" (s 741(b)).

The Revenue accept in a letter dated 9 November 1990 to Royal Life that "Personal Portfolio bonds" are bona fide commercial transactions. This is without any qualification. Mr. Tabbush demurs. He says that they are such transactions for Royal Life but not for Professor Willoughby. I do not agree. If a contract is entered into by two people and it is a bona fide commercial transaction for one of them, it cannot be not a bona fide commercial transaction for the other party to the contract in the absence of any reason for impeaching the latter's good faith.

Turning to the taxation aspect Mr. Tabbush suggests that Professor Willoughby would have invested his superannuation payment from the University and would have received income from the investment. If he had left in Hong Kong the units he received from the Save and Prosper Ten Plus policies income would have arisen on which he would have been taxed in the

A UK. He invested the money and the said units in a personal portfolio bond (in the Isle of Man). In reality that was no different from retaining in his own name the investments as they stood in Hong Kong. He merely reduced his liability to tax without involving himself in the loss or expenditure (bar small administrative charge) which entitles him to that reduction. In a normal policy, the premium is invested in a pool of securities shared with all the other policyholders (which they cannot, but Royal Life can, change at will). Professor Willoughby's policy is invested in securities including unit trusts unique to him and which he can change at will. There was little administrative difference between holding shares directly and holding them through a Bond.

C I have read and reread Mr. Tabbush's Notes of Argument, my own note, and the Revenue letters to Professor Willoughby dated 27 June and 8 August 1991 in order to understand why the 98 per cent. offshore unit linked life policies which provide "a standard menu of pooled funds" fall within Lord Templeman's concept of (acceptable) tax mitigation whereas the policies taken out by Professor Willoughby are said to fall within the concept of (unacceptable) tax avoidance. All policies are subject to the same tax regime. Any policy may be a single premium policy which may be large or relatively small; if premia are recurrent the effect is merely to add to the investment in terms of units. Most if not all policyholders will have been advised more or less comprehensively on the advantages and disadvantages (fiscal and otherwise) of offshore and onshore policies (I have in mind PFC's paper). The sole difference appears to lie in the ability to Professor Willoughby and others like him to nominate an investment to be included in the fund to which the policy is tied. The 98 per cent. of policyholders do not have this power. The life office makes its own selection, the policyholder having made a selection at the inception of the policy. Nevertheless it may be supposed that the aim and object of the 98 per cent. of policyholders is likely to be the same as Professor Willoughby's. I cannot see that the 98 per cent. seek the less to avoid liability to income tax or that the 2 per cent. seek the more to avoid such liability by virtue of that one distinction. The essence of the matter is that the tax regime is the same. Investment flexibility greater or less can hardly be determinant of the category of tax saving into which a policyholder falls.

G It is suggested by Mr. Tabbush that there is little difference between the fund held by Royal Life and Professor Willoughby holding the investments directly. This glosses over the fact that the Bond is by its nature a long term investment since there is a penalty imposed on withdrawals for eight years and there are no "front end" commissions charged on making an investment. H Additionally Professor Willoughby himself looked on the Bond as a long term arrangement. In all the circumstances I am unable to find that that arrangement falls within Lord Templeman's description of tax avoidance any more than the arrangements made by the vast majority (98 per cent.) of the holders of offshore policies.

I Professor Willoughby must nevertheless satisfy me either (a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected or (b) that the transfers made by him whilst resident in the UK and operations associated therewith were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation.

Although Professor Willoughby was never asked in cross examination whether avoiding liability to taxation was not one of the purposes for which the transfer of investments to Royal Life was effected in 1989 and 1990 (or in 1986) and he denied in re-examination that it was, I take it that I can draw my own conclusions on the facts (of which, of course, his denial is one) whether it was or was not such a purpose. This involves weighing up the evidence and it could be the case that though Professor Willoughby did not have such a purpose he does not satisfy me on balance of probabilities that that is so. The onus is on him.

In 1986 he had a substantial sum of money from the University provident fund for investment. With that money he wanted to make further provision for his eventual retirement. He was well aware of the tax aspects. He wanted an investment which could be a substitute for a s 226 retirement annuity. PFC advised him regarding tax advantages and tax disadvantages. He specifically chose a Royal Life offshore Bond since the income could be rolled up gross and it was subject to a tax regime recently introduced by Parliament.

From a commercial point of view an offshore bond had the attraction that the incidence of tax was bearable. It was tax efficient though he would not be able to utilise his personal relief from capital gains tax, Professor Willoughby perceived other advantages in the Bond, flexibility, security, economy which were nonetheless perceived by him even though to some extent on examination before me some may have been less significant than he had thought in 1986. That does not detract from them as he perceived them at that time. I do not consider that because you adopt a course which is less fiscally expensive than another your purpose in adopting the one course involves as a corollary that one of your purposes is avoiding liability to taxation, specially if the one course falls within a tax régime which Parliament considers appropriate.

With regard to the 1989 and 1990 transfers, the case is a fortiori because under one of the three options in the letter of 1 February 1989 (second option) the units from the Save and Prosper Ten Plus policies could have been left where they were in the Ten Plus Fund subject to the same tax regime Parliament imposed in 1984. But that option was not adopted since Professor Willoughby wanted some flexibility with regard to the investments. Moreover he could have extended the period of maturity by another ten years.

Overall I find that having regard to the origin overseas of the provident fund payment and the Save and Prosper Policies providing for Professor Willoughby's retirement their application in the acquisition of Royal Life Bonds had the same continuity of purpose, to make further provision for his retirement. Taxation was taken into account. It could not be otherwise. But I do not find that avoiding liability to taxation was one of the purposes for which the transfer of the provident fund payment or the units in the Save and Prosper Ten Plus policies or associated operations were effected. On balance I find that Professor Willoughby makes out his case under s 741(a). I also find that the transfers and associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation. They were designed for the increase of Professor Willoughby's retirement funds taking advantage of a favourable tax regime and not for the purpose of avoiding liability to taxation. The augmentation in August 1990 of Bond No.1121 does not fall to be treated differently .

A In making these findings I bear in mind the celebrated passage from Lord Upjohn's speech in the House of Lords in *Commissioners of Inland Revenue v. Brebner* 43 TC 705, at page 718; [1967] 2 AC 18, at page 30.

B "My Lords, I would only conclude my judgment by saying, when the question of carrying out a genuine commercial transaction, as this was, is considered, the fact that there are two ways of carrying it out—one by paying the maximum amount of tax, the other by paying no, or much less, tax—it would be quite wrong as a *necessary* consequence to draw the inference that in adopting the latter course one of the main objects is, for the purposes of the section, avoidance of tax. No commercial man in his senses is going to carry out commercial transactions except upon the footing of paying the smallest amount of tax involved."

14. Sixth Issue

D This is whether Article 3(2) of the Double Taxation Arrangement between the UK and the Isle of Man prevents s 739 applying to the industrial or commercial profits of Royal Life, an insurance company resident in the Isle of Man and not having a permanent establishment in the UK.

E Premiums were paid to Royal Life for the issue of policies to Professor and Mrs. Willoughby. Income and gains have accrued to Royal Life, a Manx enterprise, from the investment fund attached to the Bond. On redemption or surrender of a policy, Professor Willoughby or Mrs Willoughby or their respective estates are entitled only to the policy value with respect to each bond and not to the underlying investments contained in the fund attached to the Bond.

F Article 3(2) of the Arrangement provides:—

"The industrial or commercial profits of a Manx enterprise shall not be subject to UK tax unless [as is not the case] the enterprise is engaged in trade or business in the UK through a permanent establishment situated therein ..."

G A "Manx enterprise" means "an industrial or commercial enterprise or undertaking carried on by a resident of the Island". Royal Life is such an enterprise. The term "industrial or commercial profits includes rentals in respect of cinematograph films" (Article 2(1)(i) and (i)).

H Mr. Carnwath submits that the income and gains arising from the investments in the fund attached to the Bonds accrue to Royal Life, are profits of Royal Life derived from its commercial activities and therefore are commercial profits of Royal Life, a Manx enterprise. Such profits "shall not be subject to UK tax". An Arrangement of this kind "shall, notwithstanding in any enactment, have effect in relation to income tax and corporation tax in so far as [it provides]—(a) for relief from income tax, or from corporation tax in respect of income or chargeable gains ..." (s 788 (3)(a)).

I Mr. Carnwath argues that the exemption attaches to the profits. Section 739 attributes them (or part of them) to Professor Willoughby, a UK resident. Therefore they are exempt from UK tax. In support of this argument he cites *Padmore v. Commissioners of Inland Revenue* [1989] STC

493; 62 TC 352 in which it was held that a UK resident partner of a Jersey resident partnership having no UK place of business was entitled to relief from UK tax in respect of his share of the partnership profits under an Article contained in the Jersey Double Taxation Agreement corresponding to Article 3(2) of the Manx Arrangement. A

For the Crown Mr. Tabbush contends that the exemption under Article 3(2) is personal to the Manx enterprise: Royal Life cannot be taxed in the UK on its industrial or commercial profits. It does not follow that those profits cannot be taken as the measure of anyone else's profits. Secondly, he says that the investment income of Professor Willoughby's portfolio does not form part of Royal Life's "commercial profits" which must mean the net surplus arising from Royal Life's business of managing investments and available for distribution to Royal Life's shareholders. Only the charges and commissions levied by Royal Life represent its profits. Most of the profits it is said must be kept in the Funds attached to Professor Willoughby's Bonds. B C

I go back in s 739(2). I ask myself what income of Royal Life has Professor Willoughby power to enjoy (now or in the future) which, if it were his income received in the United Kingdom would be chargeable to income tax? It must surely be the income arising from the investments owned by Royal Life accepted in specie as a premium or purchased with the cash paid by way of a premium. That income whether it would or would not have been chargeable to income tax apart from the provisions of s 739 is to be deemed to be income of Professor Willoughby for all the purposes of the Income Tax Acts. As part of Royal Life's income it would not have been chargeable in fact or by virtue of the Arrangement Article 3(2), nevertheless it is to be deemed to be Professor Willoughby's income. May one apply the provisions of the Arrangement to that income deemed to be his when the actual income is not subject to UK tax for so Article 3(2) provides? One cannot, as it seems to me, apply the provisions twice nor to two different people. D E F

In my opinion there is a distinction between actual income of an individual and actual income of another person which is deemed to be the income of the individual. Such income is not industrial or commercial profits of the individual nor quoad the individual is it deemed to be industrial or commercial profits or deemed to be his income as if it were such profits. I distinguish *Padmore's* case since Padmore has a real share in real profits of a real partnership. Professor Willoughby's income under s 739 is deemed to be his when in reality it is not his although the receipt of the actual income by Royal Life enunes indirectly to some extent to his or his estate's ultimate benefit when he surrenders a policy or a policy matures. G H

I hold therefore that the income of Royal Life deemed to be Professor Willoughby's income does not come within the provisions in Article 3(2). It is not exempt from UK tax by virtue of the Arrangement. I

15. Conclusion

(a) I uphold the Board's rejection of Professor Willoughby's claims for relief under the Double Taxation Arrangement with the Isle of Man.

(b) I discharge the assessments.

A D. A. Shirley

} Commissioner for the Special
Purposes of the Income Tax
Acts

15-19 Bedford Avenue
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23 March 1993

C The Crown's appeal was heard in the Court of Appeal (Glidewell, Hobhouse and Morritt L.JJ.) on 6 and 7 December 1994 when judgment was reserved. On 16 December 1994 judgment was given against the Crown, with costs.

D *Alan Moses Q.C.* and *Launcelot Henderson* for the Crown.

David Goy Q.C. and *Philip Baker* for the taxpayers.

E The following cases were cited in argument in addition to the cases referred to in the judgment:—*Regina v. Special Commissioners of Income Tax* ex parte *Philippi* 44 TC 31; [1971] 1 WLR 1272; *Sheppard v. Commissioners of Inland Revenue* (No. 2) 65 TC 724; [1993] STC 240.

F **Morritt L.J.**:—These are appeals of the Commissioners of Inland Revenue from the determinations of the Special Commissioner, Mr. David Shirley, contained in written decisions dated 23 March 1993 discharging assessments to income tax raised against Professor Willoughby and his wife under s 739 Income and Corporation Taxes Act 1988 and its statutory predecessor. Those sections were enacted for the purpose of preventing individuals avoiding income tax by the transfer of assets to persons resident abroad. Before the Special Commissioner a number of points were raised, all but two of which he decided in favour of the Revenue. The points he decided against the Revenue and which are the subject matter of these appeals are:—

H 1. whether the individual making the transfer must be ordinarily resident in the United Kingdom at the time of the transfer; and

2. whether the taxpayers had established the exemptions provided for by s 741 that either:

I a) the purpose of avoiding liability to tax was not the purpose or one of the purposes for which the transfer or any of the associated operations had been made;

or

b) the transfer and the associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to tax.

The first point is one of construction of the statute and the facts relevant to it may be shortly stated. By July 1985 Professor Willoughby had been resident in Hong Kong, where he was professor of law at the University of Hong Kong, for a number of years and was neither resident nor ordinarily resident in the United Kingdom. He decided to take early retirement with the intention of returning to live in England and gave one year's notice to that end.

On retirement in July 1986 he became entitled to a lump sum payment from the University's provident fund. On advice he put this lump sum, paid in Hong Kong dollars and converted on behalf of Professor Willoughby into United States dollars, into a single premium personal portfolio bond with Royal Life Insurance International Ltd., a company incorporated, managed, controlled and resident in the Isle of Man. In exchange, on 8 August 1986 Royal Life issued to him a number of policies of insurance linked to fund 1121. The investments in that fund and any subsequent changes in investment were decided on by Personal Financial Consultants Ltd. as the fund adviser appointed by Professor Willoughby. Professor Willoughby returned to England and became ordinarily resident in the United Kingdom in May 1987.

The relevant legislation is now contained in Chapter III of Part XVII of the Income and Corporations Taxes Act 1988. For present purposes there is no material difference from its statutory predecessor s 478 of the Income and Corporation Taxes Act 1970. It is as follows:—

“739. Prevention of avoidance of income tax.

(1) Subject to section 747(4)(b), the following provisions of this section shall have effect for the purpose of preventing the avoiding by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfer of assets by virtue or in consequence of which, either alone or in conjunction with associated operations, income becomes payable to persons resident or domiciled outside the United Kingdom.

(2) Where by virtue or in consequence of any such transfer, either alone or in conjunction with associated operations, such an individual has, within the meaning of this section, power to enjoy, whether forthwith or in the future, any income of a person resident or domiciled outside the United Kingdom which, if it were income of that individual received by him in the United Kingdom, would be chargeable to income tax by deduction or otherwise, that income shall, whether it would or would not have been chargeable to income tax apart from the provisions of this section, be deemed to be income of that individual for all purposes of the Income Tax Acts.

...

742. Interpretation of sections 739 to 741.

(1) For the purposes of sections 739 to 741 ‘an associated operation’ means, in relation to any transfer, an operation of any kind effected by any person in relation to any of the assets transferred or any assets representing, whether directly or indirectly, any of the assets transferred, or to the income arising from any such assets, or to any assets representing, whether directly or indirectly, the accumulations of income arising from any such assets.

A (2) An individual shall, for the purposes of section 739, be deemed to have power to enjoy income of a person resident or domiciled outside the United Kingdom if—

B (a) the income is in fact so dealt with by any person as to be calculated, at some point of time, and whether in the form of income or not, to enure for the benefit of the individual; or

(b) the receipt or accrual of the income operates to increase the value to the individual of any assets held by him or for his benefit; or

C (c) the individual receives or is entitled to receive, at any time, any benefit provided or to be provided out of that income or out of moneys which are or will be available for the purpose by reason of the effect or successive effects of the associated operations on that income and on any assets which directly or indirectly represent that income; or

D (d) the individual may, in the event of the exercise or successive exercise of one or more powers, by whomsoever exercisable and whether with or without the consent of any other person, become entitled to the beneficial enjoyment of the income; or

(e) the individual is able in any manner whatsoever, and whether directly or indirectly, to control the application of the income.

...

E 743. Supplemental provisions.

(1) Income tax at the basic rate shall not be charged by virtue of section 739 in respect of income which has borne tax at the basic rate by deduction or otherwise but, subject to that, income tax so chargeable shall be charged under Case VI of Schedule D.

...

F (4) Where an individual has been charged to income tax on any income deemed to be his by virtue of section 739 and that income is subsequently received by him, it shall be deemed not to form part of his income again for the purposes of the Income Tax Acts."

G Following the determination of the Special Commissioner and the absence of any appeal it is now, in effect, common ground that:—

H 1. section 739 can apply to a transfer of assets situated outside the United Kingdom made by a transferor at a time when he was ordinarily resident in the United Kingdom;

2. the deferral of a liability to United Kingdom income tax can constitute the avoidance of liability to income tax for the purposes of s 739; and

I 3. the income and gains sought to be imputed to the taxpayers under s 739 are not exempted from tax in the United Kingdom by the Double Tax Arrangement between the United Kingdom and the Isle of Man.

But the question remains whether s 739 can apply to a transfer of assets made by a transferor at any time when he is not ordinarily resident in the United Kingdom. The Special Commissioner decided that it could not.

To explain his conclusion and the argument before this Court, it is necessary to trace the history of the relevant legislation. The original enactment was made in, for present purposes, identical terms in s 18 Finance Act 1936. The taxpayers seek to rely on statements, as recorded in Hansard, relating to the proposal for that legislation made to the House of Commons by Mr. Neville Chamberlain, then the Chancellor of the Exchequer, on 21 April 1936 and by Mr. W.S. Morrison, then the Financial Secretary to the Treasury, on 15 June and 1 July 1936. One issue that arises on this appeal is whether the decision of the House of Lords in *Pepper v. Hart* 65 TC 421; [1993] AC 593 entitles them to do so.

The first occasion when the relevant provisions were considered in any detail material to the point now in issue was the decision of the House of Lords in *Congreve & Another v. Inland Revenue Commissioners* 30 TC 163; [1948] 1 All ER 948. As recorded in the headnote the House of Lords decided that

“An individual can, within the meaning of s 18 of the Finance Act, 1936, be said to acquire rights ‘by means of’ a transfer of assets though the transfer is effected neither by the individual nor by his agent, but by a company, the whole or greater part of the share capital of which is held by or on behalf of that individual.”

The point at issue on this appeal came before the Court of Appeal in Northern Ireland in *Herdman v. Commissioners of Inland Revenue* 45 TC 394; [1968] NI 74 in considering the proper construction of the legislation then in force which was contained in s 412 Income Tax Act 1952. The Court decided that the section did not require that the transferor should be ordinarily resident in the United Kingdom at the time of the transfer. In that case there was an appeal to the House of Lords but this point was not argued or decided.

In 1979 the House of Lords had to consider in *Vestey v. Inland Revenue Commissioners* 54 TC 503; [1980] AC 1148 the ambit of the legislation then contained in s 412 Income Tax Act 1952 in relation to assessments raised for years prior to 1969–70.

I shall have to refer to the speeches in detail later. For the moment it is sufficient to record that the House of Lords decided that the section was limited in its operation and charging effect to the individual who was the transferor of the assets and that, in consequence, *Congreve & Another v. Inland Revenue Commissioners* had been wrongly decided.

It was in these circumstances that the Special Commissioner concluded that s 739 and its predecessor, s 478 Income and Corporation Taxes Act 1970, did not apply to the transfer made by Professor Willoughby to Royal Life in respect of the single premium personal portfolio bond issued to him in August 1986 because Professor Willoughby was not then ordinarily resident in the United Kingdom. He considered that the principle established by the decision of the House of Lords in *Vestey*, though not directly in point, linking the transfer with the individual necessitated linking the transfer with such an individual as is referred to in subs (1), namely one who is ordinarily resident in the United Kingdom. He thought that the decision in *Herdman* could not be relied on after the decision in *Vestey* because of the reliance in the former case on *Congreve* which had been reversed by the latter; preferring

A instead the statement in Whiteman on Income Tax 3rd Edition, para 23-08 that the transferor must be ordinarily resident in the United Kingdom at the time of the transfer of assets in question. He said that any lingering doubt he might have had was put to rest by the statements recorded in Hansard to which I have referred.

B The Revenue contend that the Special Commissioner was wrong. It is submitted that the point is covered by the decision in *Herdman* which this Court should follow as persuasive authority on the construction of a revenue statute applicable throughout the United Kingdom and because *Herdman* was right in principle, not wholly dependent on the validity of the decision in *Congreve* and unaffected by the decision in *Vestey*. It is submitted that the speeches made in the House of Commons in 1936, as reported in Hansard, do not affect the conclusion either because of their content or because the legislation has been amended twice since the decision in *Herdman*. Professor Willoughby supports the decision of the Special Commissioner essentially for the reasons he gave.

D In *Congreve & Another v. Inland Revenue Commissioners* 30 TC 163; [1948] 1 All ER 948, the issue was whether the transferor of the relevant assets had to be the individual avoiding the liability to income tax. It was argued for the taxpayer that as the transferor and that individual were different people the consequence was that the section, then s 18 Finance Act 1936, could not apply. This argument was rejected by the House of Lords. E Viscount Simonds said, [1948] 1 All ER 948, at page 952; 30 TC 163, at pages 204-205

F "The preamble or introductory words of the section which state its purpose do not, in my view, assist the contention, which was developed on its operative words, that the avoidance by an individual of liability to tax must be achieved by means of a transfer of assets effected by that individual. They are, on the contrary, in the widest possible terms, and I do not know what better words could be used if the legislature intended to define its purpose as covering a transfer of assets by A, by means of which B avoided liability to tax. When I turn to the operative words, I cannot reach any other conclusion. It was urged that in their context the words 'by means of any such transfer' can mean only a transfer effected by the individual who avoids tax liability. It was said that they do not mean the same as 'as a result of' or 'by virtue or in consequence of' and the immediate proximity of the latter phrase was referred to as pointing the contrast. My Lords, this is altogether too fine a distinction. The difference of language is sufficiently explained by the wish of the draftsman not to use the same expression twice, but it is to my mind clear, first, that in their ordinary grammatical sense the words, 'by means of' do not connote any personal activity on the part of the person who is said to enjoy or suffer something by those means, and, secondly, that in their present context it is not necessary or legitimate, in order to give a limiting sense to the words, to read them as if they were followed by such words as 'effected by him.' It was suggested in the course of the argument that other limiting words should be written in, such as 'effected by him or by his procurement' for it was reasonably apprehended that to read the section as excluding a case where an individual did not himself transfer assets but procured their transfer by another would be to ignore the substance of the legislature's intention, but I see no reason for any limiting words. The language of the section is plain. If there has been

such a transfer as is mentioned in the introductory words, and if an individual has by means of such transfer (either alone or in conjunction with associated operations) acquired the rights referred to in the section, then the prescribed consequences follow.”

Thus he specifically rejected the argument for the taxpayer that the words “effected by him” should, as a matter of construction, be interpolated after the words “transfer of assets”.

In *Herdman v. Commissioners of Inland Revenue* [1969] 1 WLR 323, 45 TC 394, the transferor was the same person as the individual who had avoided the liability to income tax but the initial transfer which had enabled that result was made by him at a time when he was not ordinarily resident in the United Kingdom. The taxpayer argued that the relevant section, then s 412 Income Tax Act 1952, could not apply on the basis that the reference to “such an individual” in subs (1) must refer back to the individual referred to in the preamble namely one “ordinarily resident in the United Kingdom”. This argument was rejected by Lord MacDermott L.C.J., with whom Curran and McVeigh L.JJ. agreed. After quoting the passage in the speech of Viscount Simonds in *Congreve & Another v. Inland Revenue Commissioners* 45 TC 394, to which I have referred, he said at page 405A–D

“The individual, accordingly, at whom s 412 is aimed is the person who seeks to avoid liability to charge, irrespective of whether he was or was not a participant in setting up the scheme for avoidance. This explains the reference to ‘ordinarily resident in the United Kingdom’, for that points to those who would gain by the avoidance rather than to those who may have contrived it—perhaps in some earlier year. There seems to be no reason why the section should make such residence necessary for those who play a part in the scheme for avoidance at the time they do so, and I do not think the language used provides for such a requirement. The section is drafted in comprehensive terms and there can be no doubt it was intended to cast a wide net.

That being the nature of the enactment, it would be surprising if Parliament had left such a large loophole open as would be the case if Mr. Potter’s argument were well founded. Contrast, for example, the following instances. A, whose career abroad ends when he attains a certain age, decides to retire to the United Kingdom, and before his return from abroad transfers: his United Kingdom assets to a company he has incorporated in the Irish Republic with a view to future tax avoidance. B, on the other hand, who has always been resident in the United Kingdom, does likewise for the same reason. Why should A be outside and B within s 412? Neither the wording of the section nor its underlying purpose seems to me to call for such an anomalous distinction. I would therefore hold against the Appellant on this branch of the case.”

It is true that that passage refers to two reasons for the decision, namely the principle established in *Congreve* and the loophole which any other construction would reveal.

But, in my judgment, it is plain that the value of the decision as persuasive authority must depend heavily on the validity of the decision in *Congreve*. As I have already indicated the decision of the House of Lords in *Congreve* was reversed by the House of Lords in *Vestey v. Inland Revenue*

A *Commissioners* 54 TC 503, [1980] AC 1148. In my judgment, it follows that such persuasive authority, as the decision in *Herdman* would otherwise have had, is destroyed.

B But before leaving *Herdman*, it is necessary to consider its aftermath. The case also involved another point on which the Revenue was unsuccessful. They appealed unsuccessfully to the House of Lords. In the Finance Act 1969 legislation was enacted, s 33, to nullify the decision of the House of Lords on the latter point but leaving untouched the decision of the Court of Appeal in favour of the Revenue on the former point. This was followed by the re-enactment of s 412 Income Tax Act 1952 in s 478 Income and Corporation Taxes Act 1970.

C In my judgment, a consideration of this forensic and legislative history shows that the reports of the speeches of Ministers when introducing the legislation in 1936, even if the conditions laid down in *Pepper v. Hart* [1993] AC 593 for allowing reference to such statements are complied with, are of no value. Whatever might have been the intention of Ministers in 1936, the Court had decided in 1948 and again in 1969 that the words used by Parliament manifested a different intention. Yet in 1952 and again in 1970 the same formula is used and notwithstanding the changes made in 1969. In these circumstances, it must be assumed that the original intention, whatever it was, was superseded by acceptance of the decisions of the courts.

E Thus the question must be decided on the basis of the wording of the sections with such assistance as may be derived from the decision of the House of Lords in *Vestey v. Inland Revenue Commissioners* [1980] AC 1148. In that case two individuals ordinarily resident in the United Kingdom transferred assets situate abroad to non-resident trustees to be held by them on trust to accumulate the income with power to advance capital and subject thereto on discretionary trusts for classes of beneficiaries comprising members of their respective families. Both the transferors were dead and the income had been accumulated. The Revenue sought to assess the beneficiaries under what was then s 412 Income Tax Act 1952 in respect of a proportion of the income of the trust fund irrespective of whether it reflected the capital sums advanced to them. The House of Lords concluded that the Revenue was not entitled to do so because none of the beneficiaries so assessed had been a transferor. In view of the unjust and indeed unconstitutional result of any other decision on the construction of the section the House of Lords decided that the decision in *Congreve & Another v. Inland Revenue Commissioners* [1948] 1 All ER 948; 30 TC 163 should be overruled.

H There are a number of passages in the speeches which require consideration. At [1980] AC 1148, at page 1174, 54 TC 503, at pages 583H–584B Lord Wilberforce referred to the question of construction in these terms

I “There are undoubtedly two possible interpretations of section 412, particularly having regard to the preamble.

The first is to regard it as having a limited effect: to be directed against persons who transfer assets abroad; who by means of such transfers avoid tax, and who yet manage when resident in the United Kingdom to obtain or to be in a position to obtain benefits from those assets. For myself I regard this as being the natural meaning of the

section. This avoids all the difficulties discussed above. No difficulty arises from cases of multiple transferors. A

The second is to give the whole section an extended meaning, so as to embrace all persons, born or unborn, who in any way may benefit from assets transferred abroad by others. This is or follows from the *Congreve* interpretation. This I regard as a possible but less natural meaning of the section." B

Later, [1980] AC 1148, at page 1176, 54 TC 503, at page 585 A–B he referred to the meaning which he thought to be the natural meaning as

"The alternative which is supported by the language is to suppose that the section was intended by Parliament as a limited section, attacking, with penal consequences, those who removed assets abroad so as to gain tax advantages while residing in the United Kingdom and not a section representing such a departure from principle, yet without any prescribed mechanism to operate it, as the alternative can now be seen to involve." C D

Viscount Dilhorne dealt with the point in the passage at [1980] AC 1148, at pages 1182/3, 54 TC 503, at pages 589F–590B in the following terms.

"I can see no ground for distinguishing that case [*Congreve*] from this, so unless the House is prepared to hold that that case was wrongly decided, the appellants must in my opinion succeed on this issue. E

Cohen L.J. with whose judgment Lord Simonds agreed on all points treated the words 'such an individual' in subsections (1) and (2) as meaning an individual ordinarily resident in the United Kingdom. Their meaning does not appear to have been debated in the House. A possible meaning appears to me an individual ordinarily resident who has sought to avoid liability to income tax by means of a transfer of assets abroad. If that was their meaning, then the scope of section 412 is limited. If, on the other hand, the words just mean an individual ordinarily resident in the United Kingdom, the decision of this House in *Congreve v. Inland Revenue Commissioners* 30 T.C. 163 was I think right. F G

Lord Simonds in the course of his speech did not refer to subsection (8) of the section. It states, inter alia: 'For the purposes of this section— (a) a reference to an individual shall be deemed to include the wife or husband of the individual; ...' These words have considerable significance and importance if 'such an individual' means an individual ordinarily resident in the United Kingdom who has sought to avoid income tax by the transfer of assets abroad. If the decision in *Congreve* is right, it is not easy to attach significance to them. Mr. Nolan suggested that they might have been inserted to cover a case where a husband and wife jointly but not separately had control of a company. I find it difficult to accept that this provision was inserted by Parliament to meet that situation. I think it is much more likely that they were inserted to secure that the wife or the husband of the transferor was brought within the scope of the section and I consequently regard this provision as an indication that by 'such an individual' is meant an individual who has sought to avoid tax by the transfer of assets abroad." H I

A Lord Salmon agreed with Lord Wilberforce. At [1980] AC 1148, at page 1195, 54 TC 503, at page 601 A–D Lord Edmund-Davies said

B “But the alternative explanation, my Lords, may in the instant case be that the fault lies not in section 412 of the Act of 1952, but in the way in which it (like its forerunner, section 18 of the Act of 1936) has been interpreted. In my judgment, the words ‘such an individual’ appearing in subsections (1) and (2) hark back to the opening words of the preamble, namely to individuals whose purpose is the avoidance of liability to tax, and do *not* refer simply to any individual ‘ordinarily resident in the United Kingdom.’ Indeed, as the noble and learned Lord, Viscount Dilhorne, has observed, if the latter, restricted interpretation is to be adopted it is not easy to see why subsection (8) of section 412 provided that: ‘For the purposes of this section—(a) a reference to an individual shall be deemed to include the wife or husband of the individual; ...’. As was submitted in the respondents’ printed case: ‘[Sub-section (8), (a)] has a positive and important function if the [Respondents] ... are correct; but otherwise is superfluous.’ And, indeed, Walton J. [1979] Ch. 177, 183, had himself expressed the view that ‘... the provisions of subsection (8) (a) ... do not otherwise make good sense ...’. It follows that in my judgment the extension of section 412 by the judgment of this House in *Congreve v. Inland Revenue Commissioners* [1948] 1 All E.R. 948 to beneficiaries wholly disconnected with the original transferor or transferors was erroneous.”

E Finally, at [1980] AC 1148, at page 1197, 54 TC 503, at page 602F–G Lord Keith of Kinkel said

F “I have arrived at the firm opinion that the principal ground of decision in *Congreve* was indeed erroneous. I consider that the natural and intended meaning of the words ‘such an individual’ in section 412(1) is that they indicate not merely an individual ordinarily resident in the United Kingdom, but an individual so resident who has sought to avoid liability to income tax by means of such transfers of assets as are mentioned in the preamble.”

G It is common ground that the point raised on this appeal was not an issue in *Vestey* for both transferors in that case were ordinarily resident in the United Kingdom at the time of the transfers. For the Revenue it is contended that the principle of *Vestey* has no bearing on the point at all. For the taxpayers it is submitted that the logic of it supports their case.

H There is no doubt that in *Vestey* the House of Lords overruled *Congreve*. In *Congreve* the House of Lords had rejected the submission that as a matter of construction the words “effected by him” should be interpolated after the words “transfer of assets” in what is now subs (1). It seems to me that the logic of the decision in *Vestey* is that that interpolation should now be made. If it is then it establishes the link between the transferor and the individual which, it seems to me, carries with it the requirement that the transferor should be ordinarily resident in the United Kingdom.

I The same result is reached by a consideration of the focus of attention of the majority of the House of Lords in *Vestey*. The passages in the speeches of Viscount Dilhorne, Lord Edmund-Davies and Lord Keith of Kinkel which I have quoted indicate an approach which refers not to the point of time at which the tax is avoided or to the achievement of that purpose but rather to

the act which initiates that result or the point of time when the transfer which enables the subsequent avoidance to be achieved is carried out. As the individual in question has to be ordinarily resident in the United Kingdom at whatever is the relevant time, it follows from this that the transferor must be so resident at the time of the transfer.

This consideration also deals with the anomaly which Lord MacDermott referred to in *Herdman*. For if, as the House of Lords considered in *Vestey*, the section is of limited effect then there is no reason to extend it, the more so as the effect of the extension would be to discourage the return of the expatriate rather than to penalise those who, being amenable to the United Kingdom legislation due to their ordinary residence, seek to avoid a liability to income tax.

For these reasons I would decide the first point in the same sense as the Special Commissioner and in favour of the taxpayer. The consequence would be that the assessments based on the income of the fund underlying bond 1121 should be discharged. This would dispose of the appeal in relation to that bond. But it is not a point that arises with respect to bonds 2387 and 3343. Thus it is necessary to deal with the second point in respect of those bonds and also with bond 1121 in case I am wrong on the first point.

The second point concerns the applicability of s 741 which is in the following terms:

“741. Exemption from sections 739 and 740.

Sections 739 and 740 shall not apply if the individual shows in writing or otherwise to the satisfaction of the Board either—

(a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected; or,

(b) that the transfer and any associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation.

The jurisdiction of the Special Commissioners on any appeal shall include jurisdiction to review any relevant decision taken by the Board in exercise of their functions under this section.”

In order to deal with this point it is necessary to explain the facts in more detail.

As I have already indicated Professor Willoughby and his wife were resident in Hong Kong from 1973 until May 1987 in the case of the former and 13 August 1986 in the case of the latter. During that period they effected three ten-year term policies with Save and Prosper International Insurance Ltd. of Bermuda. These policies were effected on the advice of PFC. They were dated respectively 14 February 1979, 26 February 1981 and 14 January 1982. Each of them was certified by the Revenue under para 1(1)(a) Sch 2 Finance Act 1975 as a “qualifying policy”. Premia were payable monthly and the policies matured after ten years. Each provided for linking the benefits payable to the performance of certain specified funds, which might be changed from time to time at the instance of the policy-holder. The conditions enabled the holder to postpone maturity for a further ten years on

A paying further premia over the extended period.

B On 17 November 1983 the Revenue published a press release entitled "Offshore and Overseas Funds; Life Assurance Policies issued by Non-Resident Life Offices" foreshadowing the intention of the Revenue to seek
C legislation designed to tax in the hands of the policy-holder the income and capital gains accruing from the underlying investments on and after 1 January 1984. Professor Willoughby was concerned at the effect this might have on the policies issued by Save and Prosper to him and his wife and wrote to the Financial Secretary about it. But the relevance for present purposes is that the press release did not refer to the legislation then in force equating to s 739 (and Professor Willoughby did not know about it until
D after all the policies with which this appeal is concerned had been effected) but it did bring home to Professor Willoughby the provisions for taxing in the hands of a policy-holder the income and capital gains of an offshore fund underlying the policy. The relevant legislation is now contained in Chapter II of Part XIII Income and Corporation Taxes Act 1988 as applied by s 553 to non-resident policies and offshore capital redemption policies. The broad effect is to tax the policy holder with both standard rate and higher rate tax on the benefits received by him. In the case of both onshore and offshore policies the holder may withdraw not more than 5 per cent. per annum of the value of the policy without then paying tax on it. Tax on the benefits obtained are payable on maturity or other chargeable event.

E I have already referred to the fact that the single premium personal portfolio bond taken out with Royal Life in August 1986 was on the advice of PFC. That advice reflected the contents of PFC's own pamphlet entitled "The Single Premium Bond: The Offshore and Onshore Versions" written in the light of the legislation foreshadowed in the Revenue press release which is
F now contained in Part XIII Income and Corporation Taxes Act 1988. The conclusion and summary stated

G "The bond has been designed to provide a tax efficient, flexible and easily controlled form of capital investment, and international results have proved this right. There are marginal extra costs over and above direct investment in unit trusts but set against a long term investment, these must be acceptable. The question for the expatriate of 'On-shore v. Off-shore' is easily balanced and depends on personal circumstances, but the latter still continue to provide an excellent long term accumulation investment vehicle for the secure range of deposit and bond funds."

H A pamphlet issued by Royal Life in 1988 emphasised: particular advantages of the private portfolio bond as being investment in a portfolio structured to meet the investor's individual requirements, the ability to appoint the investment of one's choice, all the benefits of a personal international portfolio, accumulation virtually free of tax and access to capital at all times.

I The proposal for the first bond (No. 1121) was completed by both taxpayers on 21 July 1986. They appointed PFC to be the fund advisers. As I have said already, the policies thereunder were issued on 8 August 1986. There were 19 of them; the first 18 recorded the payment of a single premium of \$US10,000 and the tenth of \$US11,963. The general conditions linked the benefits payable to the value of the underlying investments.

The finding of the Special Commissioner in respect of this bond was as follows⁽¹⁾

“A Royal Life policy appealed to Professor Willoughby as he considered that it provided him with something like a s 226 retirement annuity in that he could make annual withdrawals free of tax within limits, the withdrawals resembling an annuity, but unlike an annuity capable of being timed, a feature which is not unique to Royal Life bonds. Professor Willoughby was concerned about the tax charging provisions under Finance Act 1984 (now s 539 *et seq* Taxes Act) but he decided to accept them and forego the capital gains tax reliefs to which he would have been entitled on realisation of investments held by himself. It was his understanding also that the expense or the charges levied by Royal Life were less than those charged by a stockbroker or by PFC for managing his investments. In this he was right but it emerged in cross-examination of Mr. Wilkie that the difference may not have been as much as he had supposed. If that be the case I find that Professor Willoughby was not aware of it at any material time. He knew that there were no “front end charges” of 5 per cent. which he would have had to pay had he himself bought units in investment trusts. In this way the policy was 5 per cent. more valuable to him than a direct investment would be. There was a strong disincentive to procure the surrender of the policy within eight years of effecting it since there would be an appreciable charge for doing so.”

As I have already recorded Mrs. Willoughby returned to England on 13 August 1986 and Professor Willoughby in May 1987. Thereafter they were both ordinarily resident in the United Kingdom until, contrary to their original plans, they moved to and became resident in Alderney in May 1992.

On 1 February 1989 Matheson PFC (London) Ltd., who had by then become the Willoughbys’ advisers, wrote to Professor Willoughby concerning the options open to him on the maturity of the first Save and Prosper ten-year policy. They were as follows

“1. Convert into a UK whole life contract which would provide you with income free from personal tax liability in the future. However, the underlying funds in which the investment would be held would have to be Save & Prosper’s standard UK range and all of these would be taxed on income received as well as capital gains. The growth would, therefore, be substantially less than an equivalent fund which was not taxed. As you do not intend to start drawing an income for several years it would seem to be important to get the gross roll-up.

2. Convert the policy into an offshore whole life policy which would provide gross roll-up on the underlying funds but the income, when taken, would be liable to personal tax at both basic and higher rates. The investment funds which would be available to you under these circumstances would be Save & Prosper’s offshore funds, IPF and some of the Jardine Fleming offshore funds. The 5% per annum withdrawal, free from tax liability would apply.

3. Take the tax-free proceeds and invest in an offshore Personal Portfolio Bond. This would provide gross roll-up in the investment fund selected and there is virtually no restriction on what investment may be

(1) Page 721 *ante*.

A selected, including building society and bank deposits, gilts and equities. There is total flexibility to be able to switch between all these investments as thought necessary. The 5% p.a. tax-free withdrawal facility is available but on final surrender the gain is subject to basic and higher rate tax if applicable at that time. Using this re-investment vehicle would enable the bond to be written on your joint lives but to be owned
B by your wife, which means that any amount withdrawn in excess of 5% would be regarded as taxable income in her hands and could be set off against her own Personal Allowance which will apply as from April 1990. This would be a tax efficient thing to do.”

C In the event Professor Willoughby chose option 3 and decided to effect a further single premium personal portfolio bond with Royal Life (No. 2387). The proposal was made by his wife, the premium being the value of the investments to be received from Save and Prosper. Those investments were transferred *in specie* to the fund linked to the second bond and the appropriate policies were issued to Mrs. Willoughby on 13 March 1989.

D In the case of the second bond the Special Commissioner said⁽¹⁾

“He did not select option 3 for the purpose of avoiding UK tax. If he had appreciated any serious risk from the application of s 739 he would have selected option 2.”

E In February 1990 the procedure was repeated with the surrender values of the second and third Save and Prosper policies. The investments were transferred to Royal Life in payment of the single premium due for the policies in respect of the bond (No. 3343) which were issued to Mrs
F Willoughby on her application. In the case of both the second and third bonds the nominated investment adviser was Matheson PFC (London) Ltd.

Finally in August 1990 three further policies were issued to the taxpayers under the first bond in return for further investments added to the fund attributed to that bond.

G In paras 7(18) and (19) of his decision the Special Commissioner said⁽²⁾

H “(18)(a) There are in evidence brochures issued by Royal Life giving details about private portfolio bonds. Professor Willoughby was provided with a brochure by PFC after he had signed the proposal forms in 1986. It played no part in his decision to invest in bond No. 1121. He relied on the advice he received from PFC. The brochures current in 1989 and 1990 played no greater part since at that time he had the advice of Matheson PFC (London) Ltd. The earliest brochure containing any reference to s 739 is dated June 1990.

I (b) PFC have many clients investing in these bonds, the majority of whom retire in Hong Kong. They are useful where an individual receives a lump sum on retirement. They are appropriate for residents in the European Community and Australia. Their favourable tax treatment is an attraction. Administratively they are convenient for an individual since Royal Life does all the work. Royal Life is an efficient company and it is backed by a strong parent company in the UK.

⁽¹⁾ Page 74B *ante*.

⁽²⁾ Pages 74H–75C *ante*.

(19) It is an agreed fact that the effect of the arrangements was that the income arising in respect of the three bonds during the years of assessment in issue was (apart from the operation of s 739 and its predecessor) free of UK income tax until such time as the respective insurance policies matured or were surrendered in such a way as to enable Professor or Mrs. Willoughby to receive sums equal to the value of the contents of the fund. At that point, the gain arising in connection with the policies would be chargeable in accordance with s 541(1) of the Taxes Act (or its predecessor). Income has arisen in each of the three funds; gains have arisen in the fund for bond No. 1121. It is unnecessary to record here the amounts.”

On 18 March 1991 Professor Willoughby disclosed the three Royal Life bonds to the Revenue. In the ensuing correspondence the Revenue wrote

“However I should add that we do not consider it to be tax avoidance in the meaning of section 739 merely because a taxpayer chooses to invest in a policy with an offshore company. We have looked at a large number of products offered by the offshore insurance industry but we are only challenging certain highly personalised products of which the Royal Life Private Portfolio is an example. It is the Revenue’s view that by purchasing such bonds you have however unwittingly bought your way into an avoidance scheme which nevertheless does not work because of the operation of section 739.”

In his decision the Special Commissioner considered the four types of transaction described by Lord Templeman in *Commissioner of Inland Revenue v. Challenge Corporation Ltd.* [1987] AC 155, to which I shall refer later. After referring to a letter dated 9 November 1990 from the Revenue to Royal Life conceding that the personal portfolio bonds are bona fide commercial transactions the Special Commissioner concluded that in the absence of any reason for impeaching the good faith of the other party thereto it must be a bona fide commercial transaction for him as well. He considered the Revenue’s suggested distinction between bonds of this sort and all the others (98 per cent. of the whole) which they had not challenged based on the ability to nominate the underlying investments and said⁽¹⁾

“The sole difference appears to lie in the ability to Professor Willoughby and others like him to nominate an investment to be included in the fund to which the policy is tied. The 98 per cent. of policyholders do not have this power. The life office makes its own selection, the policyholder having made a selection at the inception of the policy. Nevertheless it may be supposed that the aim and object of the 98 per cent. of policyholders is likely to be the same as Professor Willoughby’s. I cannot see that the 98 per cent. seek the less to avoid liability to income tax or that the 2 per cent. seek the more to avoid such liability by virtue of that one distinction. The essence of the matter is that the tax regime is the same. Investment flexibility greater or less can hardly be determinant of the category of tax saving into which a policyholder falls.”

Finally the Special Commissioner set out the provisions of s 741 and concluded in these words⁽²⁾

(1) Page 87E *ante*.

(2) Page 88B–I *ante*.

A "In 1986 he had a substantial sum from the University provident
fund for investment. With that money he wanted to make further
provision for his eventual retirement. He was well aware of the tax
aspects. He wanted an investment which could be a substitute for a s 226
retirement annuity. PFC advised him regarding tax advantages and tax
disadvantages. He specifically chose a Royal Life offshore bond since
B the income could be rolled up gross and it was subject to a tax regime
recently introduced by Parliament.

C From a commercial point of view an offshore bond had the
attraction that the incidence of tax was bearable. It was tax efficient
though he would not be able to utilise his personal relief from capital
gains tax.

D Professor Willoughby perceived other advantages in the bond,
flexibility, security, economy which were nonetheless perceived by him
even though to some extent on examination before me some may have
been less significant than he had thought in 1986. That does not detract
from them as he perceived them at that time. I do not consider that
because you adopt a course which is less fiscally expensive than another
your purpose in adopting the one course involves as a corollary that one
of your purposes is avoiding liability to taxation, specially if the one
course falls within a tax regime which Parliament considers appropriate.

E With regard to the 1989 and 1990 transfers the case is *a fortiori*
because under one of the three options in the letter of 1 February 1989
the units from the Save and Prosper Ten Plus policies could have been
left where they were in the Ten Plus Fund subject to the same tax régime
Parliament imposed in 1984. But that option was not adopted since
Professor Willoughby wanted some flexibility with regard to the
investments. Moreover he could have extended the period of maturity by
F another ten years.

G Overall I find that, having regard to the origin overseas of the
provident fund payment and the Save and Prosper policies providing for
Professor Willoughby's retirement, their application in the acquisition of
Royal Life bonds had the same continuity of purpose, to make further
provision for his retirement. Taxation was taken into account. It could
not be otherwise. But I do not find that avoiding liability to taxation
was one of the purposes for which the transfer of the provident fund
payment or the units in the Save and Prosper Ten Plus policies or
associated operations were effected. On balance I find that Professor
Willoughby makes out his case under s 741(a). I also find that the
transfers and associated operations were bona fide commercial
H transactions and were not designed for the purpose of avoiding liability
to taxation. They were designed for the increase of Professor
Willoughby's retirement funds taking advantage of a favourable tax
régime and not for the purpose of avoiding liability to taxation. The
augmentation in August 1990 of bond No. 1121 does not fall to be
I treated differently."

The Revenue contend that that conclusion is wrong and that this Court
is entitled to reach a different conclusion consistently with the decision of the
House of Lords in *Edwards v. Bairstow & Another* 36 TC 207; [1956] AC 14.
For the Revenue it was contended that the Special Commissioner was wrong
to conclude that there was no relevant distinction between the position of the
taxpayers and others holding similar policies, about 2 per cent. of the whole,

who the Revenue contended did not satisfy the requirements of s 741 and the remaining 98 per cent. who the Revenue accepted could establish that the purpose of avoiding liability to tax was not one of the purposes for which the relevant transfers and associated operations were made. Secondly it was contended that the Special Commissioner was wrong in thinking that the fact that the taxpayers wished to provide for their retirement in a tax-efficient way was not inconsistent with the statutory exemption. In relation to para (b) it was submitted that to be commercial the transactions must be carried out as part of the trade or commerce of both parties.

For the taxpayers it was submitted that the deliberate choice of a transaction by which an asset was acquired which Parliament had determined should be subject to a specific tax régime could not be tax avoidance because the result was that the régime applicable to other transactions or types of asset did not apply. Thus it was submitted the purpose of avoiding liability to taxation was not one of the purposes for which the transfer and associated operations had been effected and that, in any event, the transfer and associated operations were bona fide commercial transactions for they were genuine, for value and at arm's length.

Both parties relied on a passage in the advice of the Privy Council delivered by Lord Templeman in *Commissioner of Inland Revenue v. Challenge Corporation Ltd.* [1987] AC 155. That case concerned the proper construction and application of legislation in New Zealand designed to counter tax avoidance. In relation to that concept Lord Templeman said, at pages 167/8

“The material distinction in the present case is between tax mitigation and tax avoidance. A taxpayer has always been free to mitigate his liability to tax. In the oft quoted words of Lord Tomlin in *Inland Revenue Commissioners v. Duke of Westminster* [1936] A.C. 1, 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.’ In that case, however, the distinction between mitigation and tax avoidance was neither considered or applied.

Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability. Section 99 does not apply to tax mitigation because the taxpayer's tax advantage is not derived from an ‘arrangement’ but from the reduction of income which he accepts or the expenditure which he incurs.

Thus when a taxpayer executes a covenant and makes a payment under the covenant he reduces his income. If the covenant exceeds six years and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the payment under the covenant.

When a taxpayer makes a settlement, he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income.

Where a taxpayer pays a premium on a qualifying insurance policy, he incurs expenditure. The tax statute entitles the taxpayer to reduction

A of tax liability. The tax advantage results from the expenditure on the premium.

B A taxpayer may incur expense on export business or incur capital or other expenditure which by statute entitles the taxpayer to a reduction of his tax liability. The tax advantages result from the expenditure for which Parliament grants specific tax relief.

When a member of a specified group of companies sustains a loss, section 191 allows the loss to reduce the assessable income of other members of the group. The tax advantage results from the loss sustained by one member of the group and suffered by the whole group.

C Section 99 does not apply to tax mitigation where the taxpayer obtains a tax advantage by reducing his income or by incurring expenditure in circumstances in which the taxing statute affords a reduction in tax liability.

D Section 99 does apply to tax avoidance. Income tax is avoided and a tax advantage is derived from an arrangement when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had."

E The principle of that statement was reaffirmed in the House of Lords in *Ensign Tankers (Leasing) Ltd. v. Stokes* (64 TC 617) [1992] 1 AC 655, at pages 675 and 681.

F The Revenue accepts that the bonds in this case are bonds or policies to which s 553 Income and Corporation Taxes Act 1988 applies. But they contend that the hallmark of such a bond or policy not effected for the purpose of avoiding a liability to taxation is that the investments to which the bond or policy is linked are pooled and the choice of individual investment does not lie with the holder of the bond or policy. It is submitted that in this case the substance of the matter is that the holder continues to manage his own portfolio but by the insertion of the bond or policy escaped tax on the income as it arises. An analogy is drawn with the example Lord Templeman gives of obtaining the tax advantage without incurring the cost or expenditure on which the advantage depends.

H I do not accept this submission or the validity of the analogy. As I have already recorded, the Revenue do not suggest that these bonds or policies are shams outside the régime imposed by s 553 Income and Corporation Taxes Act 1988. It is not a statutory condition for the application of that régime that the investments to which the policy or bond is linked must be pooled or chosen by someone other than the holder; such conditions are irrelevant to the application of that tax régime. I agree with the Special Commissioner. I can see no material difference between the position of the taxpayers and the others with bonds or policies in respect of which the Revenue seek to raise assessments under s 739 because choice of and control over the underlying investments is retained and the remaining 98 per cent. of those holding offshore bonds or policies where there is no such retention and which are accepted to satisfy s 741. Thus, in my view, all satisfy the provisions of s 741 or none of them do.

The test is whether one of the purposes was the avoidance of liability to taxation. In the context of this case that means the avoidance of liability to income tax (including higher rate tax) for that is the only type of tax in question. The Special Commissioner found in respect of the fourth issue, on which there is no appeal, that deferring liability to income tax can constitute the avoidance of liability to income tax. But he did not decide that in this case it was. As he said at the conclusion of para 12 of his decision, that was the fifth issue.

The difference between the tax consequences of an offshore and onshore policy or bond is that, because the income of the underlying investments of the former is not liable to tax in the United Kingdom as it arises, the holder of the policy or bond is liable to income tax at the standard rate on the gain as defined at maturity or other chargeable event. There is no difference in the case of higher rate tax for the holders of both types pay such tax on the gain when the chargeable event occurs. In essence that is also the difference between the holder of the private portfolio of investments and the holder of the offshore policy or bond save that in the latter case the liability to higher rate tax is also deferred.

I do not see why the choice of an offshore bond or policy, for the taxation of which Parliament has made express and recent provision, should be regarded as tax avoidance at all. The tax is not avoided, it is deferred. Moreover it is deferred to an event which Parliament has prescribed not to a time of the taxpayer's choice. If it were otherwise, the purchase by the self-employed of a retirement annuity, which attracts tax relief on the premium, favourable tax treatment of the income and gains arising in the underlying fund and beneficial options when the policy matures would amount to tax avoidance. It does not because, as Lord Templeman pointed out in *Challenge*, in such a case the taxpayer has genuinely paid the premium and complied with all the other conditions on which these advantages are available. In my judgment, the Special Commissioner was right on this point as well. The genuine application of the taxpayer's money in the acquisition of a species of property for which Parliament has determined a special tax régime does not amount to tax avoidance merely on the ground that the taxpayer might have chosen a different application which would have subjected him to less favourable tax treatment. Although said in a different context, like the Special Commissioner, I would refer to the *dictum* of Lord Upjohn in *Inland Revenue Commissioners v. Brebner* [1967] 2 AC 18, at page 30, 43 TC 705, at pages 718G–719A where he said

“My Lords, I would only conclude my speech by saying, when the question of carrying out a genuine commercial transaction, as this was, is reviewed, the fact that there are two ways of carrying it out—one by paying the maximum amount of tax, the other by paying no, or much less, tax—it would be quite wrong, as a *necessary* consequence, to draw the inference that, in adopting the latter course, one of the main objects is, for the purposes of this section, avoidance of tax. No commercial man in his senses is going to carry out a commercial transaction except upon the footing of paying the smallest amount of tax that he can. The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence.”

In my judgment, it was not one of the purposes of the transfer or of the associated operations by which the taxpayers effected any of the bonds or

A policies with Royal Life that liability to taxation should be avoided. Accordingly, in my judgment, the taxpayers did establish the defence for which s 741(a) provides and they are entitled to have all the assessments made under s 739 discharged.

B The Special Commissioner also dealt with the exemption afforded by s 741(b) and found that to be established as well. In view of my conclusion in respect of tax avoidance, the only other point which arises is whether the transfer and associated operations were “bona fide commercial transactions” and “not designed” for the purpose of tax avoidance. The arguments before this Court revealed considerable differences on the points of construction to which those words give rise. As they do not require resolution on this appeal
C I think that it is better that their further consideration awaits a case in which they are essential to the conclusion of the Court.

Accordingly, I would dismiss this appeal.

D **Hobhouse L.J.**:—I agree that these appeals should be dismissed for the reasons given by Morritt L.J.

Glidewell L.J.:—I have read the judgment of Morritt L.J. in draft, and agree with it in every respect.

E *Appeal dismissed, with costs.*

F The Crown’s appeal was heard in the House of Lords (Lords Nolan, Mustill, Hoffmann, Clyde and Hutton) on 10 March 1997 when judgment was reserved. On 10 July 1997 judgment was given unanimously against the Crown, with costs.

Launcelot Henderson Q.C. and *Rabinder Singh* for the Crown.

G *David Goy Q.C.* and *Philip Baker* for the taxpayer.

The following cases were cited in oral/skeleton argument in addition to the cases referred to in the judgment:—*Edwards v. Bairstow* 36 TC 207; [1956] AC 14; *Sassoon v. Commissioners of Inland Revenue* 25 TC 154; *Colquhoun v. Brooks* 2 TC 490; (1889) 14 App Cas 493; *Melluish v. B. M. I. (No.3) Ltd. and Others* 68 TC 1; [1996] AC 454; *Philippi v. Inland Revenue Commissioners* 47 TC 75; [1971] 1 WLR 1272; *Ashton v. Inland Revenue Commissioners* [1975] 1 WLR 1615; *Mangin v. Inland Revenue Commissioner* [1971] AC 739; *Newton v. Commissioners of Taxation of the Commonwealth of Australia* [1958] AC 450; *Furniss v. Dawson* 55 TC 324; [1984] AC 474; *Inland Revenue Commissioners v. Brebner* 43 TC 705; [1967] 2 AC 18; *MacDonald v. Inland Revenue Commissioners* 23 TC 449; [1940] 1 KB 802; *Lord Howard De Walden v. Inland Revenue Commissioners* 25 TC 121; [1942] 1 KB 389; *Stubbings v. Webb* [1993] AC 498; *Letang v. Cooper* [1965] 1 QB 232; *Commissioner of Inland Revenue v. Challenge Corporation Ltd.* [1987] AC 155.

Lord Nolan:—My Lords,

In this appeal the Commissioners of Inland Revenue seek to uphold five assessments to income tax, four of which were made on the Respondent Professor Willoughby for the years of assessment 1987–88 to 1990–91 inclusive and the fifth of which was made on his wife, the Respondent Mrs. Willoughby, for the year of assessment 1990–91. The assessment upon Professor Willoughby for 1987–88 was made under s 478 of the Income and Corporation Taxes Act 1970. The remaining assessments were made under s 739 of the Income and Corporation Taxes Act 1988, which replaced and re-enacted s 478 of the Act of 1970 without material alteration. The origin of these sections is to be found in s 18 of the Finance Act 1936, a section whose provisions, either in their original or in their re-enacted form, have been considered by your Lordships' House on previous occasions. It will be convenient, and sufficient for all relevant purposes, if as a general rule I refer to these provisions in the form in which they appear in the Act of 1988.

Section 739 is the first section in Chapter III of Part XVII of the Act, which is concerned with the transfer of assets abroad. The purpose which the section is intended to serve appears from subs (1) which reads as follows:—

“(1) Subject to section 747(4)(b), the following provisions of this section shall have effect for the purpose of preventing the avoiding by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfers of assets by virtue or in consequence of which, either alone or in conjunction with associated operations, income becomes payable to persons resident or domiciled outside the United Kingdom.”

The charging provision upon which the Crown rely is subs (2), which is in these terms:—

“(2) Where by virtue or in consequence of any such transfer, either alone or in conjunction with associated operations, such an individual has, within the meaning of this section, power to enjoy, whether forthwith or in the future, any income of a person resident or domiciled outside the United Kingdom which, if it were income of that individual received by him in the United Kingdom, would be chargeable to income tax by deduction or otherwise, that income shall, whether it would or would not have been chargeable to income tax apart from the provisions of this section be deemed to be income of that individual for all purposes of the Income Tax Acts.”

By virtue of s 742(9)(a), the reference in s 739 to an individual is to be deemed to include the wife or husband of the individual. Section 742 also contains definitions of a number of the other words and phrases used in s 739, such as “transfer”, “power to enjoy” and “associated operations”, but fortunately it is unnecessary to consider any of these definitions because it is common ground between the parties that by virtue or in consequence of transfers of assets to Royal Life Insurance International Ltd. (“Royal Life”), a person resident or domiciled outside the United Kingdom, Professor and Mrs. Willoughby had power to enjoy income of Royal Life at a time when they were ordinarily resident in the United Kingdom, that is to say during the tax years for which the disputed income tax assessments were made upon them.

A More specifically, the facts upon which the claim for tax is based are these. In 1973 Professor Willoughby took up employment as Professor of Law at the University of Hong Kong and he and Mrs. Willoughby became resident there. The University had a Provident Fund Scheme of which Professor Willoughby was a member, but he wished to make additional provision for his retirement. This additional provision included the taking
B out of three offshore personal portfolio bonds with Royal Life. The first bond (No.1121) was taken out by Professor and Mrs. Willoughby jointly in August 1986, with funds provided by Professor Willoughby on his retirement as Professor of Law at the University of Hong Kong. The second bond (No. 2387) was taken out by Mrs. Willoughby in March 1989, and was funded by the proceeds of an earlier offshore policy taken out by Professor and Mrs.
C Willoughby in 1979 with Save and Prosper International Insurance Ltd., ("Save and Prosper"), a Bermudan insurance company. The third bond (No. 3343) was taken out by Mrs. Willoughby in March 1990, and was funded by the proceeds of two further policies which had also been taken out by Professor and Mrs. Willoughby with Save and Prosper, in 1981 and 1982 respectively. There is no dispute that the payments of premiums on the taking out of these policies were transfers of assets to Royal Life for the purposes of s 739, nor is there any dispute about the amount of income arising from the investments comprised in the bonds which is the subject of the various assessments. The premium on the first bond was, however, paid on 8 August 1986 when both Professor and Mrs. Willoughby were still resident outside the United Kingdom. They contend that for this reason alone no liability to tax can arise upon the income of the first bond, because they say s 739 only applies to transfers of assets by individuals who are ordinarily resident in the United Kingdom at the time of the transfer.
D
E

The Special Commissioner accepted this contention. So did the Court of Appeal. My Lords, so do I. It has now been made clear, by the decision of your Lordships' House in *Vestey v. Inland Revenue Commissioners* [1980] AC 1148, 54 TC 503 reversing the first part of its decision in *Congreve v. Inland Revenue Commissioners* 30 TC 163 that the charging provisions of the section can be applied only to the individual (or the wife or husband of the individual) who has made the relevant transfer of assets. At [1980] AC 1148, at pages 1174-1175 (54 TC 503, at page 583H-I) Lord Wilberforce described the section as being:
F
G

"... directed against persons who transfer assets abroad; who by means of such transfers avoid tax, and who yet manage when resident in the United Kingdom to obtain or to be in a position to obtain benefits from those assets."
H

He added: "For myself I regard this as being the natural meaning of the section."

I Mr. Henderson Q.C., for the Crown, pointed out that Lord Wilberforce, with whose speech Lord Salmon and Lord Keith of Kinkel agreed, expressed himself in terms which did not support the Respondents' case but which were perfectly consistent with the Commissioners' case. Lord Wilberforce did not indicate that the individual to be charged had to be ordinarily resident in the United Kingdom at the time of the relevant transfer: on the contrary, he confined his references to the case of individuals who avoid tax "when resident in the United Kingdom".

This submission had not formed part of the Crown's written case, and was, I suspect, put forward by Mr. Henderson in argument to ward off the reliance placed in the written case of the Respondents upon other passages in the *Vestey* speeches, in particular those of Viscount Dilhorne at [1980] AC 1148, at page 1183A-C and again Lord Keith of Kinkel at page 1197F-H implying or assuming that liability depended upon the individual being ordinarily resident in the United Kingdom at the time of the transfer.

My Lords, I am satisfied that no useful purpose would be served in the present case by comparing these various passages in the *Vestey* speeches. Their Lordships in *Vestey* were simply not concerned with the particular question which arises in the present case. The transferors in *Vestey* had been ordinarily resident in the United Kingdom at all material times. If I were to read anything relating to the present issue into the words used by Lord Wilberforce, it would be merely that he was leaving the matter open.

Leaving *Vestey* aside Mr. Henderson submitted that the suggested restriction of liability to individuals who were ordinarily resident here at the time of transfer was unwarranted by the statutory language, and would give rise to anomalies. It would not be sensible, he argued, to distinguish between the cases of an individual intending to take up residence in the United Kingdom, who made a transfer of assets with a view to the future avoidance of United Kingdom tax and who settled here a few days after the transfer, and another individual acting with precisely the same intention who settled here a few days before making an identical transfer. The sensible time at which to consider the question of residence, Mr. Henderson submitted, was the time at which the income from the transferred assets arose, and the avoidance of tax would (but for the section) take place. He reminded your Lordships that in the second part of its decision in *Congreve* this House had held that this latter approach should be adopted in relation to the residence of the transferee. In consequence of *Congreve* it matters not, for the purposes of the section, if the transferee was resident in the United Kingdom at the time of the transfer. It suffices if the transferee is non resident at the time when the relevant income arises and the avoidance of tax would otherwise take place. This part of the *Congreve* decision was unaffected by the subsequent decision in *Vestey*.

Finally, Mr. Henderson invoked the persuasive authority of a decision by the Court of Appeal in Northern Ireland, in the case of *Herdman v. Commissioners of Inland Revenue* 45 TC 394 ([1968] NI 74). One of the issues raised in *Herdman* was precisely that now raised before your Lordships, and it was resolved by the Court of Appeal in favour of the Crown. The Crown appealed unsuccessfully to your Lordships' House on another aspect of the case but there was no appeal by Mr. Herdman against the decision of the Court of Appeal on the point now in dispute.

Before considering the *Herdman* decision I must return to that part of the *Congreve* decision which was reversed by your Lordships' House in *Vestey*. In *Congreve* the Commissioners of Inland Revenue had successfully contended that for the purposes of liability under s 18 of the Finance Act 1936 the identity of the transferor of the assets in question was immaterial. I mention in passing that this contention ran directly counter to what the House of Commons had been told by the Financial Secretary to the Treasury when the Finance Bill of 1936 was being debated. The Financial Secretary had made it plain that, for liability to arise under the section the transfer of

A assets must have been made by the individual who was to be assessed. Indeed
the Financial Secretary went further and said that “there has to be a transfer
of assets abroad by an individual resident in this country”: Hansard (H.C.
Debates), Vol. 313 Col. 685. That, of course, was long before the decision of
your Lordships’ House in *Pepper v. Hart* [1993] AC 593 (65 TC 421), and the
B possibility of referring to statements in Parliament as a guide to the
intentions of the legislature was not considered. Even if it had been
considered, it seems that no such reference would have been permitted under
Pepper v. Hart principles, because your Lordships’ House detected no
ambiguity in the section. The leading speech was given by Lord Simonds,
and at (30 TC 163 at page 205) he said:

C “The language of the section is plain. If there has been such a
transfer as is mentioned in the introductory words, and if an individual
has by means of such transfer (either alone or in conjunction with
associated operations) acquired the rights referred to in the section, then
the prescribed consequences follow.”

D This was the state of the law when the case of *Herdman* came before the
Court of Appeal in Northern Ireland. In March 1951, Mr. Herdman while
resident in the Republic of Ireland had transferred assets to a company
which was also resident in the Republic. In October 1953 he became resident
in the United Kingdom. Like Professor and Mrs. Willoughby in the present
E case, he contended that the section did not apply to him because he had not
been ordinarily resident in the United Kingdom at the time of the transfer.
Not surprisingly in the light of *Congreve*, the contention failed. After citing
the speech of Lord Simonds in that case Lord MacDermott C.J., said at 45
TC 394 at page 405:

F “The individual, accordingly, at whom s 412 is aimed is the person
who seeks to avoid liability to charge, irrespective of whether he was or
was not a participant in setting up the scheme for avoidance. This
explains the reference to ‘ordinarily resident in the United Kingdom’, for
that points to those who would gain by the avoidance rather than to
those who may have contrived it—perhaps in some earlier year. There
seems no reason why the section should make such residence necessary
G for those who play a part in the scheme for avoidance at the time they
do so, and I do not think the language used provides for such a
requirement.”

H Mr. Henderson accepts that in so far as the *Herdman* decision was thus
based upon the reasoning in *Congreve* it cannot avail him. He submits,
however, that the reversal of *Congreve* by *Vestey* does not of itself lead to a
conclusion that *Herdman* was wrongly decided, and he relies upon a passage
in the judgment of Lord MacDermott immediately following that which I
I have quoted. In this passage Lord MacDermott said that “it would be
surprising if Parliament had left such a large loophole open as would be the
case” if the taxpayer’s argument were correct, and that neither the wording
of the section nor its underlying purpose seem to call for such “an
anomalous distinction” as would arise if an individual who was resident in
the United Kingdom at the time of the relevant transfer was caught by the
section, but one who was non-resident at that time escaped liability. These,
then, are the grounds upon which Mr. Henderson bases his case that the
contention put forward by Professor and Mrs. Willoughby gives rise to
anomalies, and is, he submits, unwarranted by the statutory language. I now
return to that language.

The crucial words, as it seems to me, are those in subs (1) which state that the section is to “have effect for the purpose of preventing the avoiding by individuals ordinarily resident in the United Kingdom of liability to income tax by means of transfer of assets,” coupled with the identification, in subs (2), of “such an individual” as the subject of liability. What can the words “such an individual” refer to save for an individual of the kind described in subs (1), that is an individual ordinarily resident in the United Kingdom seeking to avoid liability by means of transfers of assets? Although the point was not determined in *Vestey*, the view there taken that the individual to be charged must be the individual who made the transfer seems to me to lead inevitably to the conclusion that the individual concerned must be the only type of transferor with which the section is concerned, and that is a transferor ordinarily resident in the United Kingdom. At the risk of seeming over confident in expressing an opinion about language which has been construed in diametrically opposite senses by your Lordships’ House in the past, I would say in the light of *Vestey* that this is the natural and plain meaning of the words used.

I accept that in consequence the immigrant tax avoider who makes his dispositions before taking up residence in this country would escape liability under the section. I would for my part find it fruitless to speculate whether this consequence was foreseen and accepted, or arose through inadvertence. I would not, in any event, regard it as sufficiently astonishing in itself to cast doubt on what I have described as the natural meaning of the words used, and I do not believe that Lord MacDermott’s remarks in *Herdman* were intended to go so far. As I read them, these remarks were made by way of comment upon what Lord MacDermott regarded as a satisfactory result of the *Congreve* decision rather than as an independent ground for his own decision.

I accept also, that, at first sight, there appears to be something of an imbalance in a statutory requirement that the transferor must be ordinarily resident at the time of the transfer, but not the transferee. But the appearance of imbalance is, to my mind, little more than superficial. So far as the words used are concerned, it is to be noted that it is sufficient that income becomes payable to the non-resident person “by virtue or in consequence” of the transfer, either alone or in conjunction with associated operations. This wording is apt to cover the case where there has been a lapse of time between the transfer and the accrual of income to the non resident person. It is scarcely surprising that the legislature should have contemplated and provided for such a case. Otherwise it would have been too easy, as the facts of *Congreve* show, for liability under the section to be escaped by means of the relevant transfer being made to a resident person who thereafter became non resident.

I therefore conclude that the income from Bond No. 1121 does not fall within the embrace of subss (1) and (2), because Professor Willoughby was not ordinarily resident in the U.K. when he purchased it. I would only add by way of postscript that Parliament, has now, by s 81 of the Finance Act 1997, changed the law in respect of income arising on or after 26 November 1996.

In the case of Bonds No. 2387 and No. 3343 which were taken out after Professor and Mrs. Willoughby had become ordinarily resident in the United Kingdom, s 739 is plainly applicable unless it is displaced by s 741 which reads as follows:—

A "Sections 739 and 740 shall not apply if the individual shows in writing or otherwise to the satisfaction of the Board either—

(a) that the purpose of avoiding liability to taxation was not the purpose or one of the purposes for which the transfer or associated operations or any of them were effected; or

B (b) that the transfer and any associated operations were bona fide commercial transactions and were not designed for the purpose of avoiding liability to taxation."

C The Special Commissioner, Mr. Shirley, found that Professor and Mrs. Willoughby had discharged the burden of proof thus imposed upon them under both para (a) and (b) in relation to all three policies, although strictly, of course, the exemption under s 741 was not required for the first policy.

D I have mentioned that the first of the Royal Life bonds was taken out with the funds arising from the Hong Kong Provident Fund Scheme, and the second and third with the proceeds of three policies taken out by Professor and Mrs. Willoughby with Save and Prosper in Bermuda. I note in passing that each of these policies was certified by the Revenue under para 1(1)(a) of Sch 2 to the Finance Act 1975 as a "qualifying policy". The effect of such certification, under the law then in force, was that the profits of the policy on maturity would be entirely free of United Kingdom tax.

E On 17 November 1983 the Revenue published a press release entitled "Offshore and Overseas Funds; Life Assurance Policies issued by Non-Resident Life Offices". The press release made clear the Government's intention to introduce legislation in the 1984 Finance Act which would:

F (i) In general prevent new policies of Life Assurance issued by Non-Resident Life Offices from being qualifying policies;

G (ii) Change the rules for computing the tax charge on profits received by U.K. resident policy holders from non-qualifying policies issued by non-resident life offices, so that on the maturity of the policy, and in certain other events, the holder would be liable to both basic and higher rate income tax on the profits.

H Thus the total freedom from tax accorded to the benefits derived by Professor Willoughby from policies such as his Save and Prosper policies would cease to be available. The general rule for the future was that profits from policies issued by non-resident life offices would carry with them a liability to income tax on the benefits received at the time when they accrued. Until that time, however, the income and capital gains arising from the funds comprised in the policy could be accumulated free of United Kingdom tax. The new legislation bringing about these results was enacted in 1984 and is now incorporated in ss 539 to 554 of the Income and Corporation Taxes Act 1988.

I In 1985 Professor Willoughby decided to take early retirement from the University and in July of that year he gave one year's notice accordingly. On retirement he was due to receive a lump sum payment from the University's Provident fund. He sought advice from Personal Financial Consultants Ltd. ("PFC"), a company which he had earlier consulted before taking out his Save and Prosper policies. He accepted their advice to put his money into a single premium personal portfolio bond taken out with Royal Life.

It is common ground that Professor Willoughby's sole concern in consulting PFC was to provide for his ultimate retirement and to have an arrangement which would be flexible and also simple for his wife to deal with in the event of his death. At the time the first bond was taken out Professor Willoughby had made up his mind to return to live in the United Kingdom. The avoidance of United Kingdom tax was not in his mind, although he was well aware of the tax aspects of the policy. He could hardly fail to be, because they were naturally stressed in the Royal Life advertising material. Professor and Mrs. Willoughby were, of course, resident in the United Kingdom when the second and third bonds were taken out. It was not suggested that there is any difference between the three bonds as regards either their inherent nature or the purposes for which they were acquired.

The principal feature distinguishing a personal portfolio bond from other bonds issued by Royal Life was that the purchaser of the personal portfolio bond retained the ability to choose, switch and manage the investments comprised in the fund to which the bond was linked. Personal portfolio bonds amounted to some 2 per cent. of the total of bonds issued by Royal Life, the remainder being bonds linked to what was described as a fixed menu of investments, selected by Royal Life. It was only the personal portfolio bonds which were regarded by the Commissioners as falling foul of s 739. The remainder, it was accepted, were exempt by reasons of the provisions of s 741(a).

In order to understand the line thus drawn, submitted Mr. Henderson, it was essential to understand what was meant by "tax avoidance" for the purposes of s 741. Tax avoidance was to be distinguished from tax mitigation. The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the tax legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option. Where the taxpayer's chosen course is seen upon examination to involve tax avoidance (as opposed to tax mitigation), it follows that tax avoidance must be at least one of the taxpayer's purposes in adopting that course, whether or not the taxpayer has formed the subjective motive of avoiding tax.

My Lords, I am content for my part to adopt these propositions as a generally helpful approach to the elusive concept of "tax avoidance", the more so since they owe much to the speeches of Lord Templeman and Lord Goff of Chieveley in *Ensign Tankers (Leasing) Ltd. v. Stokes* 64 TC 617, [1992] 1 AC 655 at pages 675C-676F and 681B-E. One of the traditional functions of the tax system is to promote socially desirable objectives by providing a favourable tax regime for those who pursue them. Individuals who make provision for their retirement or for greater financial security are a familiar example of those who have received such fiscal encouragement in various forms over the years. This, no doubt, is why the holders of qualifying policies, even those issued by non-resident companies, were granted exemption from tax on the benefits received. In a broad colloquial sense tax avoidance might be said to have been one of the main purposes of those who took out such policies, because plainly freedom from tax was one of the main attractions. But it would be absurd in the context of s 741 to describe as tax avoidance the acceptance of an offer of freedom from tax which Parliament

A has deliberately made. Tax avoidance within the meaning of s 741 is a course of action designed to conflict with or defeat the evident intention of Parliament. In saying this I am attempting to summarise, I hope accurately, the essence of Mr. Henderson's submissions, which I accept.

B Proceeding on this basis Mr. Henderson contrasted the position of a United Kingdom resident who directly owned the underlying investments, and one who profited from the investments through the medium of the personal portfolio bond. The former would be liable to income tax at both basic and higher rates on the income from the investments, and also to capital gains tax on chargeable gains realised on disposal. The latter, under C the tax regime applicable to overseas life policies, would pay no tax on the income or capital gains until the maturity of the bond or the occurrence of one of the other specified chargeable events.

D In these circumstances, submitted Mr. Henderson, the underlying reality of the matter is that the holder of the Royal Life personal portfolio bond continues to manage and benefit from his own portfolio of investments, but by the insertion of the bond structure he escapes tax on the income and gains from those investments as they arise. Parliament cannot sensibly have intended the statutory taxation regime for offshore life policies to apply in, such circumstances, so the purpose of an investor in such bonds cannot be characterised as mere tax mitigation.

E My Lords, there is a basic fallacy in this argument. It lies in the proposition that the "underlying reality" is that the holder of the bond continues to manage and benefit from "his own portfolio of investments". As F my noble and learned friend Lord Hoffmann pointed out in the course of argument, so far from the underlying investments being owned by the bond holder, he has no legal or equitable interest in them whatever. As clause 12 G of the Policy makes clear the allocation of investment units to the bond for which the policy provides is purely notional. Units are referred to solely for the purpose of computing benefits under the policy. The reality in truth is that the bond holder has a contractual right to the benefits promised by the policy, no more and no less. It is therefore quite wrong to describe the bond holder as having, in the words of the Appellants' printed case "in substance all the advantages of direct personal ownership without the tax disadvantages". The significance of this misdescription would become all too apparent if—perish the thought—Royal Life were to become insolvent and unable to meet its obligations to the bond holders.

H This fallacy goes to the heart of the Crown's case. For the attack which they have launched against Professor and Mrs. Willoughby and other Royal Life bond holders is limited as I have said to those who hold personal portfolio bonds, that is to say bonds under which the bond holder has effective control of the investment policy, the Crown accepting that the remaining offshore bonds issued by Royal Life do not involve the avoidance I of tax.

Like the Special Commissioner and the Court of Appeal, I am unable to follow the reasoning of the Crown. The personal portfolio bond holder may fare better or worse in terms of benefits by reason of his control over investment policy than does his fellow bond holder with the standard type of bond, but the difference between them seems to me to have nothing to do

with tax or with tax avoidance. I can see no reason why Parliament should have intended to distinguish between them in fiscal terms. A

It follows that, in agreement with the Court of Appeal, I would affirm the clear and carefully reasoned decision of the Special Commissioner upholding the Respondents' claim for exemption under s 741(a). It is therefore unnecessary to decide whether the Special Commissioner was equally entitled to hold that the Respondents had established their claim to the protection conferred by s 741(b) on "*bona fide* commercial transactions ... not designed for the purpose of avoiding liability to taxation". At first sight the point seems a straightforward one, but the precise scope of the phrase "*bona fide* commercial" as it occurs in the related context of section 703(1) of the Act, which also deals with tax avoidance, has given rise to dispute in a number of cases of which *Commissioners of Inland Revenue v. Goodwin* [1976] 1 WLR 191, 50 TC 583, a decision of your Lordships' House is an example. In the instant case your Lordships did not think it necessary to call upon counsel for the Respondents, and in company with the Court of Appeal I think it better to defer consideration of s 741(b) until a case arises in which it is crucial to the decision. B C D

For these reasons, I would dismiss the appeal.

Lord Mustill:—My Lords,

I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Nolan. For the reasons he gives I would dismiss the appeal. E

Lord Hoffmann:—My Lords,

I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Nolan. For the reasons he gives I would also dismiss the appeal. F

Lord Clyde:—My Lords,

I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Nolan. For the reasons he gives I would dismiss the appeal. G

Lord Hutton:—My Lords,

I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Nolan. For the reasons he gives I would dismiss the appeal. H

Appeal dismissed, with costs.

[Solicitors:—Solicitor of Inland Revenue; Messrs. Baileys Shaw & Gillett.] I
