
COURT OF APPEAL—4, 5 AND 6 APRIL AND
5 MAY 1978

B HOUSE OF LORDS—19, 20 AND 21 JUNE AND
1 NOVEMBER 1979

Commissioners of Inland Revenue v. Plummer⁽¹⁾

C *Surtax—Total income—Tax avoidance scheme—Deductions in computing total income—Covenant by surtax payer to make five annual payments to a charity—Whether such payments were “any annuity or other annual payment” and therefore deductible in computing total income—Income and Corporation Taxes Act 1970 (c 10), ss 434 and 457.*

D In the course of a tax-saving scheme, HOVAS, a charitable company, paid lump sums to surtax-paying individuals in return for covenants by those individuals to make five payments to HOVAS at yearly intervals. In particular, on 15 March 1971 P, one such surtax payer, covenanted, in return for an immediate payment of £2,480, to make to HOVAS on 29 March 1971 and in each of the four succeeding years (subject to his liability being terminated upon his death) a payment of such sum as after deduction of standard rate income tax should leave £500. HOVAS insured against the possibility of P's death during the period. It was calculated that, if the annual payments HOVAS was to receive were treated as being the gross amounts, it would earn a 36 per cent. per annum return on its outlay. P had to provide security for the future payments, but HOVAS agreed in the preliminary correspondence on 11 March 1971 to accept as security (i) a cheque for £300, to be devoted to the purchase of shares in a public company, and (ii) ten promissory notes to the total value of £2,500 purchased from OCC Ltd., a company in the SW group. Also in accordance with the scheme, P on 12 March opened a current account with SW Ltd., a bank, and arranged by standing order to pay the annual sum of £500 to HOVAS. P further instructed SW Ltd. that, when the remittance of £2,480 was received from HOVAS, the promissory notes should be purchased from OCC Ltd. and lodged with HOVAS. These arrangements were perfected at a completion meeting on 15 March 1971. HOVAS in turn pledged the promissory notes to B Ltd., another SW company, from which it had originally obtained a loan with which to purchase the annuities. This loan was originally to be repaid in five equal instalments, but B Ltd. agreed to the deferment of some of the instalments in return for the deposit of the amount of those instalments with RB Ltd., another SW company.

⁽¹⁾ Reported (ChD) [1977] 1 WLR 1227; [1977] 3 All ER 1009; [1977] STC 440; 121 SJ 559; (CA) [1979] Ch 63; [1978] 3 WLR 459; [1978] 3 All ER 513; [1978] STC 517; 122 SJ 439; (HL) [1980] AC 896; [1979] 3 WLR 689; [1979] 3 All ER 775; [1979] STC 793; 123 SJ 769.

Thereafter, on or about 29 March each year, SW Ltd. paid the £500 instalment to HOVAS, thereby causing P's current account at SW Ltd. to become overdrawn. HOVAS obtained the release of two of P's promissory notes from B Ltd. and in turn released them to SW Ltd., and SW Ltd. then encashed the two promissory notes with OCC Ltd., using the proceeds to clear the overdraft. P claimed to be entitled to deduct the gross amount of each of his five yearly payments from his total income for surtax purposes for the year in question. The Special Commissioners upheld his claim. The Crown appealed.

The Chancery Division, dismissing the Crown's appeal, held (1) that the real nature of the payments made by P to HOVAS was that they were all income payments; (2) that such payments were made "out of profits or gains brought into charge" to tax under s 52, Income and Corporation Taxes Act 1970; in the absence of any election to attribute the annuity payments to capital, P was not estopped from asserting that the payments were made out of income; *dictum* of Lord Radcliffe in *Commissioners of Inland Revenue v. Frere* 42 TC 125, 148; [1965] AC 402 applied; (3) that s 434, Income and Corporation Taxes Act 1970, did not apply as P had received the market price for the disposition, i.e. the sale of the annuity for the capital sum, and this was "sufficient consideration" within the meaning of the exception contained in s 434(1); *dictum* of Ungood-Thomas J. in *Ball v. National & Grindlays Bank Ltd.* 47 TC 287, at page 296; [1973] Ch 127 applied; (4) that, but for the decision in *Bulmer v. Commissioners of Inland Revenue* 44 TC 1; [1967] Ch 145 (which laid down the principle that a bona fide commercial transaction, containing no element of bounty, did not fall within the definition of a "settlement" for the purposes of s 457), the Crown would have been able to contend successfully that P being the settlor, and the income arising under the settlement (i.e. the annuity) being payable to a person other than the settlor (i.e. HOVAS), it was still his income for surtax purposes; (5) that in the absence of any element of bounty, the *Bulmer* principle applied, notwithstanding that the object of the scheme was tax avoidance, and consequently s 457 did not apply; (6) that the *Bulmer* principle extended also to s 434. The Crown appealed.

The Court of Appeal, unanimously dismissing the Crown's appeal, held that the conclusions of the High Court on points (1) and (2) above were correct; (3) that the exception to the operation of s 434(1), Income and Corporation Taxes Act 1970, for dispositions made for valuable and sufficient consideration imports for practical purposes the same test as that which excepts transactions which would otherwise be "settlements" from the operation of Part XVI of the Act, and s 457 in particular (that the transaction must be for full consideration and free from bounty: see *Bulmer v. Commissioners of Inland Revenue*); (4) that in determining for this purpose whether a transaction was devoid of bounty and effected for full consideration it was legitimate for the taxpayer to have had regard to the expected fiscal effects of the transaction; and that, on this basis, the Special Commissioners had effectively found as a fact that P had received the full market price for the annuity. The Crown appealed.

Per curiam; The rule in *Bulmer v. Commissioners of Inland Revenue* has no application to s 434, Income and Corporation Taxes Act 1970.

The House of Lords, dismissing the Crown's appeal by a majority, (1) (Viscount Dilhorne dissenting) held that the conclusion of the High Court and Court of Appeal on point (1) above was correct; (2) that P had taken no step which would prevent him from asserting that his annuity instalments were

- A “payable wholly out of profits or gains brought into charge to income tax” within the meaning of s 52, Income and Corporation Taxes Act 1970; (*quaere* whether there are any steps that an individual whose income exceeds the charges upon it can take which will have this effect); (3) that the consideration received by P for the annuity was valuable and sufficient within the meaning of s 434(1), Income and Corporation Taxes Act 1970, for the reasons given in the High Court and the Court of Appeal; (4) (Lord Diplock dissenting) that there was no element of bounty in what P did and (Viscount Dilhorne and Lord Diplock dissenting) that s 457, Income and Corporation Taxes Act 1970, did not apply in this case, because the term “settlement” as defined in s 454(3) embraced only transactions containing an element of bounty.

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CASE

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

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 12 and 13 April 1976 Ronald Anthony Plummer (hereinafter called “Mr. Plummer”) appealed against the following assessments to surtax: 1970–71, £3,485, 1971–72, £3,476, and 1972–73, £4,165.

2. Shortly stated the question for our decision was whether payments made in the years in question by Mr. Plummer to Home and Overseas Voluntary Aid Services Ltd. (hereinafter called “HOVAS”) in the circumstances hereinafter appearing were payments of “any annuity or other annual payment” and therefore deductible in computing Mr. Plummer’s total income for surtax purposes in those years. The circumstances are substantially the same as those considered by the Special Commissioners on 18 and 19 December 1972 in an appeal by HOVAS (hereinafter called “the HOVAS appeal”) in which one of the questions in issue was whether similar payments (made by persons other than Mr. Plummer) formed part of the income of HOVAS.

3. The following witnesses gave evidence before us: George Derek Hewson, managing director of Midland Montagu Personal Financial Services Ltd., Mr. Plummer, Robert Thomas Kablean, an actuary employed by the Appellants at the Estate Duty Office.

4. The following documents were proved or admitted before us: a bundle of copy correspondence and documents more particularly referred to in the list at the front of the bundle; a copy of the Case Stated in the HOVAS appeal on 3 June 1975. The bundle is annexed hereto marked A and forms part of this Case⁽¹⁾. The Case Stated has been transmitted to the Court pursuant to s 56(4), Taxes Management Act 1970, and is available for inspection by the Court.

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

- (a) During the years under appeal Mr. Plummer was employed as taxation manager by Slater Walker Ltd. (hereinafter called “Slater Walker”) and he acted in that capacity for the whole of the Slater Walker group of companies. He was a director of Baldrene Ltd. (hereinafter called “Baldrene”) a company in the Slater Walker group. Another company in that group was Old Change Court (Investments) Ltd. (hereinafter called “OCC”).

(1) Not included in the present print.

(b) HOVAS was a company, incorporated on 30 December 1970, which at all times material to this appeal had an authorised and issued share capital of £10 divided into shares of £1 each. It was registered under the Charities Act 1960 and had a close business association with Slater Walker. A

(c) One of Mr. Plummer's duties at Slater Walker was to ensure the efficient working of a scheme whereby, with the aid of moneys borrowed by HOVAS from Baldrene (see para 5(3) of the Case Stated in the HOVAS appeal), HOVAS held itself out as prepared to purchase annuities on terms attractive to persons who paid a high rate of surtax. The terms and an analysis of the scheme are set out in a memorandum (exhibit A1) which S. Cardale & Co. Ltd., insurance and investment brokers, (hereinafter called "Cardale") distributed to such of its clients as it thought might be interested in the scheme. The object of the scheme was to reduce the surtax liability of the vendor and to build up a tax-free fund in HOVAS. Mr. Plummer decided to take advantage of the scheme. He approached Cardale accordingly. (See Cardale's letter to Mr. Plummer of 9 March 1971 (exhibit A2).) By 11 March 1971 negotiations were concluded and it was arranged that Mr. Plummer would comply with the requirements of the scheme in the manner hereinafter appearing and in due course enter into an agreement (hereinafter called "the agreement") whereby in consideration of the payment by HOVAS to him of the sum of £2,480 he would promise to pay to HOVAS for the period of five years or during the remainder of his life (if shorter) a yearly sum which would after deduction of income tax at the standard rate for the time being in force be equal to £500. Mr. Plummer did not regard himself as having entered into any contractual arrangement at that time. The following steps were taken in accordance with the arrangement: B
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(i) On 11 March 1971 HOVAS wrote to Mr. Plummer confirming that the company would accept the security, viz., promissory notes to the value of £2,500 to be issued by OCC and a cheque for £300 (to be used for the purchase of Midland Bank Ltd. ordinary stock), which he proposed to lodge with them to secure the yearly sums (exhibit A3).

(ii) On 12 March 1971 Mr. Plummer wrote to Slater Walker requesting them to open an account in his name in their books and enclosing a remittance of £40 as an opening credit. He informed them that they would be receiving the sum of £2,480 from HOVAS on 15 March 1971 and that that sum should be credited to his account, following which they should make the following payments out of the account: (A) £15 to Cardale (this represented the charge for negotiating the agreement payable to Cardale referred to in Cardale's letter to Mr. Plummer of 9 March 1971 (exhibit A2); Mr. Plummer had persuaded Cardale that in his particular case the charge ought to be less than 5 per cent. of the purchase price of the annuity); (B) £2,500 to OCC in return for which OCC would issue ten promissory notes payable to bearer. Slater Walker were requested to accept the promissory notes and lodge them on his behalf with HOVAS as security for the due performance of his obligations under the agreement. He explained that as his obligations were fulfilled a proportion of the security given by him would be released and he requested and authorised Slater Walker to accept each release on his behalf. In the event of his account being overdrawn at the time of a release Slater Walker were to present an appropriate number of the notes in question to OCC for payment and to credit his account with the sums paid. It was agreed that interest at 2 per cent. over bank rate should be payable on a daily basis on any amount overdrawn. A standing order for the payment out of the account of the five yearly sums of £500, the first payment to be made on 29 March 1971, was enclosed with the letter (exhibits A4, A5 and A6). The said account was duly opened and the sum of £40 credited to it on or before 14 March 1971. F
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- A (iii) On 15 March 1971:
- (A) Mr. Plummer entered into the agreement (exhibit A7) and at the same time signed a memorandum addressed to HOVAS whereby he agreed to deposit with HOVAS, on the terms therein mentioned, securities having a value equivalent to twice the aggregate amount of the net yearly sums still due to be made under the agreement (exhibit A11);
- B (B) the consideration of £2,480 was paid by HOVAS, pursuant to instructions given to them by Mr. Plummer, to Slater Walker and was credited to his account with them. Thereupon Slater Walker paid out of his account the said sums of £15 to Cardale and £2,500 to OCC;
- (C) in consideration of the sum of £2,500 OCC issued ten promissory notes to bearer payable on demand, the particulars of which appear in the schedule to an agreement made on 15 March 1971 whereunder OCC agreed to pay to Mr. Plummer interest at the rate of $6\frac{1}{2}$ per cent. per annum on the amounts of such notes (exhibit A10). Slater Walker, as instructed, duly lodged the notes with HOVAS. HOVAS in turn lodged the notes with Baldrene as part of the security for Baldrene's loan to HOVAS, and Baldrene endorsed each note with a memorandum that it was charged to them as security for moneys owing
- D (exhibit A23);
- (D) Mr. Plummer lodged with HOVAS the said cheque for £300 and, by way of further security, assigned to HOVAS his right to interest under his agreement with OCC (exhibit A16). The £300 was duly invested by HOVAS in Mr. Plummer's name and the investments retained by them as security as arranged. Mr. Plummer served notice of his assignment of his right to interest
- E on OCC (exhibit A17);
- (E) five certificates of deduction of income tax pursuant to s 55, Income and Corporation Taxes Act 1970, (forms R185) were signed by Mr. Plummer and handed to Slater Walker with instructions to complete them on his behalf for use by HOVAS when claiming repayments of tax as and when each of the yearly sums was paid (exhibit A15);
- F (F) the possibility that Mr. Plummer might die during the five-year period was covered by HOVAS in an assurance policy taken out for a small premium with the Royal Insurance Group (exhibit A8). Mr. Plummer was 34 years of age at the time, in good health, and the possibility of his death during that period was a remote one. Steps (A) to (E) were all taken at a meeting which the parties or their representatives attended. The documents forming exhibits A3 to 7 and
- G 9 to 17 were in standard forms drafted in advance as a complete series for the purposes of the scheme.
- (iv) Payments under the agreement (exhibit A7) were made on 29 March in each year (the first being made on 29 March 1971) when Slater Walker debited the account of Mr. Plummer and credited the account of HOVAS with the sum of £500. Promissory notes amounting in all to £500 were released by
- H HOVAS on 31 March following the payment and that sum was on the same date paid by OCC at Slater Walker's request into Mr. Plummer's account with them. Two days' delay was caused by the fact that the promissory notes lodged with HOVAS by Mr. Plummer were in turn lodged by HOVAS with Baldrene as security for the moneys lent by Baldrene to HOVAS for the purchase of Mr. Plummer's promise. Baldrene would not release any of its security until satisfied
- I that its account had been effectively credited with an appropriate repayment. Mr. Plummer's account with Slater Walker went into overdraft during these two days and he paid interest on the amount thereof. Mr. Plummer did not pursue his request to HOVAS in his letter of 26 July 1971 for the release of the promissory notes and the acceptance of British Transport Stock in exchange (exhibit A19).

(d) (i) £851.06 was in March 1971 the grossed up equivalent of £500 before deduction of income tax at the standard rate then in force. A

(ii) In order to pay to HOVAS the five yearly sums in full (i.e. the gross equivalent of the net sums expressed to be payable after deducting income tax), with the first payment due after 14 days and the further payments annually thereafter, Mr. Plummer would have had to reckon on being able to continue to earn interest on the balance of the moneys which he received from HOVAS, after meeting each instalment, at a compound rate of interest of nearly 36 per cent. per annum in order to break even, ignoring the effects of tax and inflation. Assuming a delay of one year in the repayment to HOVAS of the tax alleged to have been deducted from the gross equivalent of each sum paid by Mr. Plummer the return to HOVAS on its outlay would be equal to compound interest of nearly 27 per cent. per annum ignoring the effects of tax and inflation. B
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(iii) None of the witnesses was aware of any other company or person whom Mr. Plummer could have approached with a view to selling to that company or person an annuity. There was, however, at least one similar scheme known to the appellants in the case of which the corresponding exercise to that explained in sub-para (ii) above threw up appreciably lower rates of interest. D

(iv) In March 1971 $2\frac{1}{2}$ per cent. Consols were yielding 9 per cent. and bank rate stood at $6\frac{1}{2}$ per cent.

6. It was contended on behalf of the Appellants that:

(a) (i) in order to discover whether each of the said sums of £500 was deductible in computing Mr. Plummer's total income it was necessary to discover whether it was "any annuity or other annual payment"; E

(ii) for the purpose of (i) above it was necessary to consider the contractual circumstances under which each such sum came to be paid;

(iii) looking at all the facts in this case the only possible conclusion was that at some time prior to 15 March 1971 Mr. Plummer and HOVAS had entered into a binding agreement to take all the steps eventually taken by each of them; F

(iv) when such binding agreement is analysed it shows that the payments made by Mr. Plummer were repayments of moneys lent to him by HOVAS and were not therefore payments of an income nature which would qualify for deduction in computing Mr. Plummer's total income;

(b) (i) fiscal advantages were not to be taken into account in ascertaining whether within the meaning of the words in parenthesis in s 434(1), Income and Corporation Taxes Act 1970, a disposition was made for valuable and sufficient consideration, because such consideration did not move from the promisee; G

(ii) if contrary to the contention in (a) the said payments had the quality of income they were not made for valuable and sufficient consideration and were, therefore, by virtue of the said s 434 to be deemed to be the income of Mr. Plummer and not to be the income of HOVAS; H

(c) (i) section 434 did not lie within any fasciculus of provisions from the operation of which bona fide commercial transactions without any element of bounty were by implication excepted;

(ii) in any event transactions were not bona fide commercial in nature if they were designed solely or primarily to obtain tax advantages;

A (d) if s 434 should not be applicable, the said payments fell to be treated as the income of Mr. Plummer and not as the income of HOVAS by virtue of s 457, Income and Corporation Taxes Act 1970;

(e) the assessment for 1970-71 should be reduced to £3,260 and the assessments for 1971-72 and 1972-73 should be confirmed.

7. It was contended on behalf of Mr. Plummer that:—

B (a) each of the sums of £500 paid by Mr. Plummer in each of the years under appeal was paid as an “annuity or other annual payment” and therefore fell to be deducted in computing his total income for surtax purposes;

(b) Mr. Plummer was not under any legal obligation prior to 15 March 1971 to take or procure the taking of any of the steps referred to in para 5(c)(iii) above;

C (c) the said sums were paid for valuable and sufficient consideration and accordingly were not to be deemed by s 434, Income and Corporation Taxes Act 1970, to be the income of Mr. Plummer;

D (d) even if the said sums were not paid for valuable and sufficient consideration the agreement was a commercial transaction without any element of bounty and accordingly neither s 434 nor s 457, Income and Corporation Taxes Act 1970, applied to deem the sums to be the income of Mr. Plummer;

(e) the assessments for 1970-71 and 1971-72 should be discharged and that for 1972-73 should be reduced to £3,349.

8. The following authorities were cited to us: *Bulmer v. Commissioners of Inland Revenue* 44 TC 1; [1961] Ch 145; *Sothorn-Smith v. Clancy* 24 TC 1; [1941] 1 KB 276; *Commissioners of Inland Revenue v. Church Commissioners for England* 50 TC 516; [1975] 3 All ER 614; *Ball v. National & Grindlays Bank Ltd.* 47 TC 287; [1973] Ch 127; *Duke of Westminster v. Commissioners of Inland Revenue* 19 TC 490; [1936] AC 1; *Campbell v. Commissioners of Inland Revenue* 45 TC 427; [1970] AC 77; *Commissioners of Inland Revenue v. Mallaby-Deeley* 23 TC 153; *Panorama Developments (Guildford) Ltd. v. Fidelis Furnishing Fabrics Ltd.* [1971] 3 All ER 16; *Dott v. Brown* [1936] 1 All ER 543; *Lupton v. F. A. & A. B. Ltd.* 47 TC 580; [1972] AC 634.

9. We, the Commissioners who heard the appeal, took time to consider our decision and gave it in writing on 30 April 1976 as follows:

G (1) The question which we have to decide in this appeal is whether payments made to HOVAS by Mr. Plummer, in circumstances substantially similar to those which were considered by the Special Commissioners on 18 and 19 December 1972 in an appeal by HOVAS (“the HOVAS appeal”), were payments of “any annuity or other annual payment” and so deductible in computing Mr. Plummer’s income for surtax purposes. A case for the opinion of the High Court was stated and signed by the Special Commissioners on 3 June 1975 following the determination of the HOVAS appeal and the circumstances relevant in this appeal are those set out in para 5 of that Case.

H (2) We do not accept the contention advanced on behalf of the Revenue that there existed at some time prior to 15 March 1971 an executory contract between Mr. Plummer and HOVAS whereby all the steps that were taken or procured to be taken, including in particular the payment of £2,480 by HOVAS to Mr. Plummer, the signing of the agreement of 15 March 1971 (“the agreement”) and the provision of security by Mr. Plummer, were bound to be taken.

The scheme, based as it was on Messrs. Cardale's circular, was clearly arranged in advance, and it is not disputed by Mr. Plummer that it was understood between the parties that all things to be done under the scheme would be done. In our opinion it is not to be inferred from such understanding that the parties were contractually bound. That was not Mr. Plummer's intention nor is there anything in the evidence before us to suggest that that was the intention of HOVAS. No contractual obligation to implement the scheme arose until at the completion meeting on 15 March 1971 HOVAS paid £2,480 to Mr. Plummer (which it did by crediting that sum to an account which he had opened for the purpose with Slater Walker Ltd. with an opening credit of £40 paid by him) in consideration of his entering into the agreement. As part of the preliminary arrangements it had been understood between the parties that once the agreement had been entered into and the £2,480 paid Mr. Plummer would purchase from Old Change Court (Investments) Ltd. ("OCC") ten promissory notes to bearer in sums totalling £2,500 which were to be lodged with HOVAS as security and to be released to Mr. Plummer as and when he complied with his obligations under the agreement. This understanding became legally binding on Mr. Plummer once the £2,480 had been paid and was complied with when Slater Walker Ltd., pursuant to instructions given by Mr. Plummer on 12 March 1971 in anticipation of the agreement, paid to OCC out of the above-mentioned account £2,500 for the notes. It was contended for the Revenue that the £2,480 paid by HOVAS had in all the circumstances the quality of a loan to Mr. Plummer which he was to repay by means of the payments under the agreement. On the true construction of the agreement, and having regard to all the circumstances in which it was entered into, we are of the opinion that the £2,480 was an outright payment to Mr. Plummer in return for his promises under the agreement. Unlike the sums in question in *Campbell v. Commissioners of Inland Revenue*⁽¹⁾ 45 TC 427 the £2,480 was not returnable to the payer either in whole or in part at any time. We do not derive any assistance from *Dott v. Brown* [1936] 1 All ER 543 in which the quality of annual payments was determined by reference to an antecedent debt. The present case is, in our view, covered by the decision of the Court of Appeal in *Sothorn-Smith v. Clancy*⁽²⁾ 24 TC 1, and in particular by the observations in the judgment of Sir Wilfred Greene M.R. in the paragraph on pages 7 and 8 of the report. Accordingly we hold that the sums paid by Mr. Plummer under the agreement were payments of an annuity or other annual payments and not repayments of a capital sum lent to him.

(3) (a) The same arguments were addressed to us on s 434, Income and Corporation Taxes Act 1970, as in the HOVAS appeal and in addition it was contended by the Revenue that, if that section did not apply, the payments made by Mr. Plummer were to be treated as part of his income for the purposes of surtax by virtue of s 457 of that Act.

(b) As to the question whether the consideration moving from HOVAS was sufficient consideration for the purpose of the words in parenthesis in s 434(1), we were not satisfied on the evidence before us that it was. Mr. Plummer was aged 34 in March 1971 and was to receive £2,480 in return for gross payments, before deduction of tax, of some £4,255 over five years. As in the HOVAS appeal it was not suggested to us that the possible depreciation of money over the five years was a factor to be taken into account and we therefore ignore it. On this footing, assuming, as was the probability, that Mr. Plummer survived the period, HOVAS would receive the equivalent of compound interest at the rate of some 36 per cent. on its outlay assuming no undue delay in repayment

(1) [1970] AC 77.

(2) [1941] 1 KB 276.

A of tax or 27 per cent. assuming a delay of one year, both yields being well in excess of yields of $6\frac{1}{2}$ per cent. to 9 per cent. available in the market at the time.

(c) We feel constrained by *Bulmer v. Commissioners of Inland Revenue*⁽¹⁾ 44 TC 1 to proceed on the basis that neither s 434 nor s 457 applies to a bona fide commercial transaction without any element of bounty. As in the HOVAS appeal it was common ground between the parties that the transaction was

B carried out at arm's length. Mr. Plummer knew of no other organisation which would have been prepared to purchase an annuity from him. From his point of view, if the tax advantages described by the brokers materialised, he would have laid out his money to excellent advantage. We regard it as a fair description of the transaction to say that it was a bona fide commercial transaction without any element of bounty notwithstanding that the benefits from it were

C largely to be derived from the tax advantages which the parties expected would accrue to them.

(4) The appeal therefore succeeds. The parties are agreed that in consequence, and we accordingly determine that, the assessments for 1970-71 and 1971-72 should be discharged and the assessment for 1972-73 should be reduced to £3,349.

D 10. The Appellants, immediately after the determination of the appeal, declared to us their dissatisfaction therewith as being erroneous in point of law and on 27 May 1976 required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970, s 56, which Case we have stated and do sign accordingly.

E 11. The question of law for the opinion of the Court is whether our decision in para 9 was correct.

A. K. Tavaré
J. G. Lewis

{ Commissioners for the Special Purposes of
the Income Tax Acts

Turnstile House
94-99 High Holborn
London WC1V 6LQ

F 18 January 1977

The case was heard in the Chancery Division by Walton J. on 22 and 23 June 1977 when judgment was reserved. On 1 July 1977 judgment was given against the Crown, with costs.

Patrick Medd Q.C. and *Peter Gibson* for the Crown.

G *Michael Nolan Q.C.* and *David Milne* for the taxpayer.

The following cases were cited in argument in addition to those referred to in the judgment:—*Ransom v. Higgs* 50 TC 1; [1974] 1 WLR 1594; *Commissioners of Inland Revenue v. Church Commissioners for England* 50 TC 516; [1977] AC 329; *Dealler v. Bruce* 19 TC 1; *Copeman v. Coleman* 22 TC 594; [1939] 2 KB 484.

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(1) [1967] Ch 145.

Walton J.—During the years with which this appeal is concerned the Respondent, Mr. Plummer, was employed as a taxation manager by Slater Walker Ltd. (“Slater Walker”). He was a director of Baldrene Ltd. (“Baldrene”), a company in the Slater Walker group. Another company in that group was Old Change Court (Investments) Ltd. (“OCC”). There was also a company called Home and Overseas Voluntary Aid Services Ltd. (“HOVAS”), which was a charitable company duly registered under the Charities Act 1960. This company had a close business association with Slater Walker, but was not part of the Slater Walker group or under the control of that company, nor were its directors associated with that company. The Slater Walker group had evolved a taxation-saving scheme which it was one of Mr. Plummer’s duties to supervise. It was aimed at high surtax payers, and in essence it was simplicity itself. HOVAS was prepared to purchase annuities from such individuals at rates which were attractive to them. This was because, as a charity, HOVAS was thought to be able to recover the tax deducted when the surtax payer paid the annuity to it, while the surtax payer was able to deduct, or was thought to be able to deduct, the amount of the annuity from his total income for the purposes of surtax. So he would receive by way of a capital sum roughly the amount which he would have to pay, over the period of the annuity, to the charity; and, as he would be able to deduct this from his total income, he would save the surtax which he would otherwise have to pay on the amount of the annuity. I do not pause to consider the relevant statutory provisions at this stage, but the ones involved are readily apparent and, indeed, well known.

The actual implementation of this extremely simple plan was, however, complicated by two main factors. First, HOVAS had not immediately available to it the funds wherewith to make the capital payments to the persons from whom it purchased the annuities; secondly, it naturally wanted security against the possible failure of any such person actually to pay the due instalment. So the scheme was in its detail complicated by requiring the person selling the annuity to provide security, basically by means of the purchase by him of promissory notes from OCC to the full amount of the instalments of the annuity, which was fixed at a five-year annuity. Since the purchase price was slightly short of this sum the result was that the purchaser had to find the small amount of the difference. In addition, other security, which could be either short-dated gilts or acceptable equities amounting to 10 or 15 per cent. of four net annual payments of the annuity, had also to be deposited with HOVAS. HOVAS then sub-mortgaged this security to Baldrene and was thus put in funds to carry on the scheme generally. The vendor had to open an account with Slater Walker and sign the usual banker’s standing order to make the five annual payments of the annuity. As each payment was made a proportionate part of the promissory notes was released from the security and, having been originally drawn so that they were payable on demand, was paid, and the proceeds were duly credited to the vendor’s account with Slater Walker. Obviously, this procedure took a day or two, during which time, unless he chose to feed the account from other sources, the vendor’s account with Slater Walker would be overdrawn, and overdraft facilities to meet this period were arranged. Of course, also, on the occasion of each payment some of the additional security would also be released and throughout the vendor would have the benefit of the income produced by the promissory notes and the other security, but would, of course, have to pay interest on the overdraft, if any. The final complication is that naturally enough, HOVAS had to guard against the possibility of the vendor’s death before all five payments of the annuity had been duly made, and HOVAS duly effected a policy to meet this contingency. Obviously the vendor had to supply the necessary particulars for the insurance to be effected, and if he died his estate would be under no liability to make any more payments.

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- A These necessary complications, as well as the bare essentials of the scheme, are all reflected in the documentation which is attached to the Case Stated, but I do not think that I need refer to that documentation in detail. Although, of course, the implementation of such a scheme requires a certain amount of pre-negotiation, it was found by the Special Commissioners, and not challenged by the Crown before me, that there were no contractual arrangements binding on
- B Mr. Plummer until 15 March 1971. But the matter under consideration was that he would sell to HOVAS on the terms of the scheme a five-year annuity of a yearly sum which would, after deduction of income tax at the standard rate for the time being in force, be equal to £500 in consideration of a sum of £2,480.

I can now pick up the story, at a late stage in the negotiations, as found by the Special Commissioners:

- C “The following steps were taken in accordance with the arrangement:
- (i) On 11 March 1971 HOVAS wrote to Mr. Plummer confirming that the company would accept the security, viz., promissory notes to the value of £2,500 to be issued by OCC and a cheque for £300 (to be used for the purchase of Midland Bank Ltd. ordinary stock), which he proposed to lodge with them to secure the yearly sums . . . (ii) On 12 March 1971 Mr. D Plummer wrote to Slater Walker requesting them to open an account in his name in their books and enclosing a remittance of £40 as an opening credit. He informed them that they would be receiving the sum of £2,480 from HOVAS on 15 March 1971 and that that sum should be credited to his account, following which they should make the following payments out of the account: (A) £15 to Cardale”, who were brokers, “(this represented the charge for negotiating the agreement . . .); (B) £2,500 to OCC in return for which OCC would issue ten promissory notes payable to bearer. Slater Walker were requested to accept the promissory notes and lodge them on his behalf with HOVAS as security for the due performance of his obligations under the agreement. He explained that as his obligations were fulfilled a proportion of the security given by him would be released and he requested and authorised Slater Walker to accept each release on his behalf. In the event of his account being overdrawn at the time of a release Slater Walker were to present an appropriate number of the notes in question to OCC for payment and to credit his account with the sums paid. It was agreed that interest at 2 per cent. over Bank Rate should be payable on a daily basis on any amount overdrawn. A standing order for the payment out of the account of the five yearly sums of £500, the first payment to be made on 29 March 1971, was enclosed with the letter . . . The said account was duly opened and the sum of £40 credited to it on or before 14 March 1971. (iii) On 15 March 1971 (A) Mr. Plummer entered into the agreement . . .” for the sale of the annuity “and at the same time signed a memorandum addressed to HOVAS whereby he agreed to deposit with HOVAS, on the terms therein mentioned, securities having a value equivalent to twice the aggregate amount of the net yearly sums still due to be made under the agreement . . . (B) The consideration of £2,480 was paid by HOVAS, pursuant to instructions given to them by Mr. Plummer, to Slater Walker and was credited to his account with them. Thereupon Slater Walker paid out of his account the said sums of £15 to Cardale and £2,500 to OCC. (C) In consideration of the sum of £2,500 OCC issued ten promissory notes to bearer payable on demand . . .” carrying “interest at the rate of 6½ per cent. per annum on the amounts of such notes . . . Slater Walker, as instructed, duly lodged the notes with
- I

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HOVAS. HOVAS in turn lodged the notes with Baldrene as part of the security for Baldrene's loan to HOVAS, and Baldrene endorsed each note with a memorandum that it was charged to them as security for moneys owing . . . (D) Mr. Plummer lodged with HOVAS the said cheque for £300 and, by way of further security, assigned to HOVAS his right to interest under his agreement with OCC . . . The £300 was duly invested by HOVAS in Mr. Plummer's name and the investments retained by them as security as arranged. Mr. Plummer served notice of his assignment of his right to interest on OCC . . . (E) Five certificates of deduction of income tax pursuant to s 55, Income and Corporation Taxes Act 1970"—those are forms R 185—"were signed by Mr. Plummer and handed to Slater Walker with instructions to complete them on his behalf for use by HOVAS when claiming repayments of tax as and when each of the yearly sums was paid . . . (F) The possibility that Mr. Plummer might die during the five-year period was covered by HOVAS in an assurance policy taken out for a small premium with the Royal Insurance Group . . . Mr. Plummer was 34 years of age at the time, in good health, and the possibility of his death during that period was a remote one."

All the above steps, taken on 15 March 1971, were taken at a meeting which the parties or their representatives attended.

"(iv) Payments under the agreement . . . were made on 29 March in each year (the first being made on 29 March 1971) when Slater Walker debited the account of Mr. Plummer and credited the account of HOVAS with the sum of £500. Promissory notes amounting in all to £500 were released by HOVAS on 31 March following the payment and that sum was on the same date paid by OCC at Slater Walker's request into Mr. Plummer's account with them. The two days' delay was caused by the fact that the promissory notes lodged with HOVAS by Mr. Plummer were in turn lodged by HOVAS with Baldrene as security for the moneys lent by Baldrene to HOVAS for the purchase of Mr. Plummer's promise. Baldrene would not release any of its security until satisfied that its account had been effectively credited with an appropriate repayment. Mr. Plummer's account with Slater Walker went into overdraft during these two days and he paid interest on the amount thereof."

It is common ground that at all material times the gross amount of the annuity sold was £851.06 (that being, of course, decimal currency).

These proceedings concern three assessments to surtax, for the years 1970-71, 1971-72 and 1972-73, the point at issue being that the Crown has refused to allow the deduction of the annuity payments from Mr. Plummer's total income for surtax purposes. Mr. Plummer appealed to the Special Commissioners, and they have found in his favour. From their decision the Crown now appeals to the High Court.

The relevant statutory provisions are few. They are:

Income and Corporation Taxes Act 1970, s 109(1) and (2) Case III(a), which reads as follows:

"(1) Tax under Schedule D shall be charged under the Cases set out in subsection (2) below, and subject to and in accordance with the provisions of the Tax Acts applicable to those Cases respectively. (2) . . . Case III—tax in respect of—(a) any interest of money, whether yearly or otherwise,

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A or any annuity or other annual payment, whether such payment is payable within or out of the United Kingdom, either as a charge on any property of the person paying the same by virtue of any deed or will or otherwise, or as a reservation out of it, or as a personal debt or obligation by virtue of any contract, or whether the same is received and payable half-yearly or at any shorter or more distant periods."

B Section 52(1), dealing with deduction of tax at the standard rate where the payment of the annuity is made out of profits or gains brought into charge for income tax:

C "Where any annuity or other annual payment charged with tax under Case III of Schedule D, not being interest, is payable wholly out of profits or gains brought into charge to income tax . . . the whole of the profits or gains shall be assessed and charged with income tax on the person liable to the annuity or other annual payment, without distinguishing the annuity or other annual payment, and . . . the person liable to make the payment, whether out of the profits or gains charged with income tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled on making the payment to deduct and retain out of it a sum representing the amount of income tax thereon at the standard rate for the year in which the amount payable becomes due, and . . . the person to whom the payment is made shall allow the deduction on receipt of the residue of the payment, and the person making the deduction shall be acquitted and discharged of so much money as is represented by the deduction, as if that sum had been actually paid and . . . the deduction shall be treated as income tax paid by the person to whom the payment is made."

D

E Section 53(1) and (2), dealing with the position where it is not paid out of profits or gains brought into charge to income tax:

F "(1) Where . . . any annuity . . . is not payable, or not wholly payable, out of profits or gains brought into charge to income tax, the person by or through whom any payment thereof is made shall . . . deduct out of it a sum representing the amount of income tax thereon at the standard rate in force at the time of the payment. (2) Where any such payment . . . is made by or through any person, that person shall forthwith deliver to the inspector an account of the payment, and shall be assessable and chargeable with income tax . . . on the payment, or on so much thereof as is not made out of profits or gains brought into charge to income tax."

G Section 3(1) and (2)(a), which I do not think I need read, eliminates the amount of the annuity from any charge to surtax.

Section 434(1) and (2), dealing with dispositions for short periods:

H "(1) Any income which, by virtue of or in consequence of any disposition made, directly or indirectly, by any person (other than a disposition made for valuable and sufficient consideration), is payable to or applicable for the benefit of any other person for a period which cannot exceed six years shall be deemed for all the purposes of the Income Tax Acts to be the income of the person, if living, by whom the disposition was made, and not to be the income of any other person. (2) In this Chapter, unless the context otherwise requires, 'disposition' includes any trust, covenant, agreement or arrangement."

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Then there is s 457, dealing with the income arising under certain settlements: A

“(1) Where, during the life of the settlor, (income arising under a settlement made on or after 7th April 1965 is, under the settlement and in the events that occur, payable to or applicable for the benefit of any person other than the settlor, then, unless, under the settlement and in the said events, the income either”—and then there is a whole list of matters, none of which applies here—“the income shall be treated for the purposes of surtax as the income of the settlor and not as the income of any other person.” B

Then one has to go, to find the definition of “settlement”, first of all to s 459(1), which in fact throws one back to s 454(3), where “settlement” is defined as “any disposition, trust, covenant, agreement or arrangement, and ‘settlor’, in relation to a settlement, means any person by whom the settlement was made.” C

On this appeal it has been argued by Mr. Medd, for the Crown, as follows: (I) When one examines the whole of the surrounding circumstances the real nature of the payments made by Mr. Plummer to HOVAS was that they were all capital payments. (II) Alternatively, the payments were not made out of profits or gains brought into charge to tax within the meaning of s 52 of the Income and Corporation Taxes Act 1970. (III) The provisions of s 434 apply, the disposition of the annuity not having been made by Mr. Plummer for “valuable and sufficient consideration”. (IV) The provisions of s 457 apply, Mr. Plummer being the settlor, and the income arising under the settlement (namely, the annuity) being payable to a person other than the settlor (i.e. HOVAS) it was by virtue of this section still his income. (V) The principle laid down in *Bulmer v. Commissioners of Inland Revenue*⁽¹⁾ 44 TC 1, to the effect that a bona fide commercial transaction did not fall within the definition of a “settlement” for the purposes of what is now s 457 does not apply to a transaction the sole *raison d'être* whereof was tax avoidance. (VI) Quite apart from this, the *Bulmer* principle did not apply to s 434. (VII) As a defensive point, in order to keep the matter open before a higher Court, *Bulmer* was wrongly decided. Apart from this last point, with which of necessity I need not deal further, it will be convenient to consider these submissions in the same order as Mr. Medd made them. D E F

(I) Mr. Medd submitted that the terms of the agreement between the parties themselves did not answer the question whether the payments were payments of income or of capital, and he cited in this regard *Campbell v. Commissioners of Inland Revenue*⁽²⁾ 45 TC 427, a case where annual sums paid to a charity under a deed of covenant were nevertheless held not to be income. However, I do not think that that case assists on this point. The reason they were held not to be income was because there was a binding agreement between the payer and payee that the sums should be used in a particular manner for the benefit of the payer. There is nothing even remotely like this in the present case. So far as Mr. Plummer is concerned, there is no contractual fetter on HOVAS making any use of the annuity payments it liked; and I do not think that the fact that it would obviously, as a matter of business, have to be in a position to return the appropriate tranche of the securities deposited by Mr. Plummer is either here or there. Then, said Mr. Medd, just look at the circulation of the money without the assistance of the contractual documents. HOVAS advances a sum to Mr. Plummer; Mr. Plummer repays it over five years. This has all the obvious G H I

(1) [1967] Ch 145. (2) [1970] AC 77.

(Walton J.)

- A characteristics of a loan and a repayment. Mr. Medd was good enough to concede that this way of putting his case might be a matter of impression. I can only say that it does not strike me that way at all. For a start, if one does look at it in that light, then something has gone sadly adrift in the arithmetic. HOVAS will have lent £2,480; it will have received in repayment the sum of £2,500 spread over five years. That is to say, it will have made £20 by way of interest out of the whole transaction. I am sure the merchant bankers of the City of London would flock to grow fat on such transactions. But I deny that, even if the arithmetic had worked for Mr. Medd instead of irrefragably against him, his method of approach would have been permissible. I think that direct authority for this is to be found in the speech of Sir Wilfrid Greene M.R. in *Sothorn-Smith v. Clancy*⁽¹⁾ 24 TC 1, at pages 6 and 7, where he makes it perfectly plain that, in order to discover the “real nature” of any transaction, it is quite impossible to leave the contractual or other arrangements out of account, and illustrates this quite convincingly by the very example of the purchase of an annuity. I am far from saying that in determining the nature of any arrangements one is necessarily to be confined to the contractual documents; but in areas where there may be two possible explanations of a payment, or series of payments, one must always start with an examination of what the parties were trying to do. One cannot legitimately strip away all evidence apart from the actual payments themselves and then say, “Lo! this is a loan and repayment.” It might well be, but it might well not; and certainly in this case there is not the slightest shadow of a reason for saying that it was.

- (II) This contention appears to me to be altogether on a different plane from the first. If one looks at what actually happened, Mr. Plummer did, as a matter of observable fact, make all the payments of the instalments of the annuity with which I am concerned out of capital moneys, namely, the encashment of the promissory notes which he had bought with the capital sum paid to him by HOVAS. Even this is not strictly accurate; he made the payments out of an overdraft allowed to him by Slater Walker, which overdraft was on every occasion discharged by the proceeds of the promissory notes. This was not, of course, an essential feature of the scheme. There would have been nothing to prevent Mr. Plummer feeding his account at Slater Walker with whatever moneys he chose. But the scheme was designed to work without there being any necessity upon him to do that (save to the minimal extent necessary to discharge the costs of any such temporary accommodation) and I think I must assume, there being no evidence to the contrary, that this is the way it in fact was worked in his particular case. Can one then say, to use the statutory language of s 52, that the annuity has been paid “out of profits or gains brought into charge to income tax” so as to enable Mr. Plummer to deduct tax from the annuity and to deduct the annuity from his income for surtax purposes? The position is neatly summarised by Lord Radcliffe in *Commissioners of Inland Revenue v. Frere*⁽²⁾ 42 TC 125, at page 148:

- I “This recognition of a division of ownership between two or more persons entitled to rights in a single ‘fund’ of income was not, however, confined to such cases as those where there was trust income or an annuity charge. There was also the case of ‘annual’ or ‘yearly’ interest—I do not distinguish between the two adjectives—payable under a mortgage, the characteristic feature of which seems to have been that, in setting up the mortgage situation, the borrower had in effect divided the gross income of his estate between himself and the mortgagee. Up to this point it could

⁽¹⁾ [1941] 1 KB 276.

⁽²⁾ [1965] AC 402.

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fairly be said that the division corresponded with and followed the lines of enforceable legal rights in an identifiable fund of property, the accruing income. But the tax system can be seen to go further than this, for it applied the same idea of division of proprietary right to situations in which legal distinctions draw no dividing line. Thus an annual payment secured by personal covenant only, involving no charge on any actual security, whether income or capital, was treated in the same way for tax purposes. It had to be 'annual', and it had also to be payable 'out of profits or gains brought into charge' in order to rank as income of payee not of payer, because it was the division of taxable income with which the code was dealing; and it may well be asked what at this stage is the significance of the words 'out of' as applied to a payment, the obligation for which was merely the personal one to find the money required out of whatever resources the payer might mobilise for the purpose. The answer was provided by the application of what is in truth an accountant's, not a lawyer's, conception, for it was accepted that, so far as the payer was found to have in the relevant year a taxable income larger than the gross amount required to make the payment, to that extent he was entitled to claim that he had made the payment 'out of profits or gains brought into charge', and to deduct and retain for his own account tax at what in due course (after 1927) became the 'standard rate.'

So the *prima facie* answer is in the affirmative. Nevertheless, there are clear exceptions, and I think that they can be formulated, as Lord Wilberforce formulated them in *Chancery Lane Safe Deposit and Offices Co. Ltd. v. Commissioners of Inland Revenue*(¹) 43 TC 83, at page 128, as follows:

"These cases, then, as I understand them, without laying down any exhaustive rule, at least show that the taxpayer loses the right which I have described as one of allocation or attribution, namely, to prepare a special account for Revenue purposes in which the annual payment is compared with the amount of his assessed profits, if he has made a decision or election in fact to attribute the payment to capital account which decision has produced practical results inconsistent with allocation to revenue."

The reported cases on this point all concern cases where some corporation has, either for the purpose of obtaining a larger subsidy than it would otherwise have done from the central government (*Corporation of Birmingham v. Commissioners of Inland Revenue*(²) 15 TC 172) or for the purpose of being in a position to pay larger dividends than it would otherwise have been able (*Central London Ry. Co. v. Commissioners of Inland Revenue*(³) [1937] AC 77; *Chancery Lane Safe Deposit* case 43 TC 83) made a clear election; or, of course, where there were in truth no such profits or gains from which the payment could have been made (*B. W. Nobes & Co. Ltd. v. Commissioners of Inland Revenue*(⁴) 43 TC 133). Now although the decided cases are all in relation to corporations, which for one reason or another have to keep accounts and which for one reason or another may have very good grounds for making a payment out of capital, I think that there can be nothing in the cases to confine the exceptions to corporations; and, indeed, Mr. Nolan, for Mr. Plummer, did not so argue. But, as pointed out by Harman L.J. in the *Nobes* case, individuals do not normally keep accounts, and so all an individual normally has to do is to show that in the year in question there were sufficient taxed profits in his hands to entitle him to make the deduction. If, then, he is to be debarred from doing this, in my judgment there must be

(¹) [1966] AC 85. (²) [1930] AC 307. (³) 20 TC 102. (⁴) [1966] 1 WLR 111.

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- A some step taken by him in relation to the payment which makes it impossible for him to say that it has so come out of income; and that will normally be because, as a result of something he has said or done, or possibly has contracted to say or do, he has reaped an advantage which, having been reaped, estops him from contending that that which he has previously asserted was not the truth. If this is the right way of looking at the matter, what has Mr. Plummer in the present case
- B done or said, *vis-à-vis* the Revenue or anybody else, which prevents him from asserting that the annuities have been paid out of income? Not only do I see nothing but, on the contrary, it appears to me that from the very beginning, if any informed observer was discussing the scheme with Mr. Plummer, and had asked, "Will the payments of the annuity come out of capital or out of income?", Mr. Plummer would have replied (it must be recalled that he was the taxation manager of Slater Walker), "Oh, out of income; this is an essential feature of the scheme from my point of view." And I can see nothing which Mr. Plummer has
- C done, or left undone, which in any way detracts from his initial and continuing intention to attribute, when the time came, the payments to income. They were, of course, actually paid out of an overdraft; but that, it seems to me, puts him in no better or worse a position than, in the example given by Lord Greene M.R. in
- D *Allchin v. Corporation of South Shields*(¹) 25 TC 445, at page 457, of the trader who spends the whole of his profits for the year in buying himself a house so that he has to borrow money in order to pay his mortgage interest. As between himself and the Revenue, he is still entitled to debit the interest against his income. In truth, Mr. Medd's argument on this point really only appears to arise because of the confusion of two quite disparate things: the actual payments made and the
- E totally notional fund to which the taxpayer is entitled to attribute them for tax purposes. I would hesitate to say that never the twain shall meet, but they have but little point of contact, one being a purely physical exercise and the other being a wholly book entry. Once this is appreciated the whole force of Mr. Medd's point, in my judgment, melts away. For beyond actually making the payment of the annuity in the manner already mentioned, there is nothing at all
- F which Mr. Plummer has done or not done upon which Mr. Medd can fasten, however one likes to put the relevant test, to establish an election by Mr. Plummer that the payment is to be notionally attributed to capital rather than income.

- (III) It will be recalled that s 434 does not apply to a disposition made for valuable and sufficient consideration. Therefore, for the section to apply at all, it
- G must be shown that the disposition—i.e. the sale of the annuity in return for the capital sum—was not, so far as Mr. Plummer is concerned, for valuable and sufficient consideration. Mr. Medd does not dispute that Mr. Plummer received the market price. Indeed, the Special Commissioners state that HOVAS, by reason of the fact that it was a charity and hoped to recover the income tax deducted on payment of the annuity from the Revenue, was able to offer attractive rates. But, he says, there was no sufficient consideration, as Mr. Plummer
- H ought to have got more. When I pressed him in relation to this startling allegation, Mr. Medd said that as the annuity was a gross annuity of £800-odd, in order for Mr. Plummer to have received sufficient consideration he ought to have received a sum £4,000, of course discounted for early payment. However, Mr. Medd did claim to have a finding of the Special Commissioners in his favour on
- I this point. Their finding is set out in para 9(3)(b) of the Case Stated as follows:

"As to the question whether the consideration moving from HOVAS was sufficient consideration for the purpose of the words in parenthesis in

(¹) [1943] AC 607.

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s 434(1), we were not satisfied on the evidence before us that it was. Mr. Plummer was aged 34 in March 1971 and was to receive £2,480 in return for gross payments, before deduction of tax, of some £4,255 over five years. As in the HOVAS appeal it was not suggested to us that the possible depreciation of money over the five years was a factor to be taken into account and we therefore ignore it. On this footing, assuming, as was the probability, that Mr. Plummer survived the period, HOVAS would receive the equivalent of compound interest at the rate of some 36 per cent. on its outlay assuming no undue delay in repayment of tax or 27 per cent. assuming a delay of one year, both yields being well in excess of yields of 6½ per cent. to 9 per cent. available in the market at the time.”

I am afraid that, in this finding, the Special Commissioners have fallen into manifold errors. In the first place, they have asked themselves the wrong question. The question is not whether HOVAS made a bargain (if they did, which I shall examine later) but whether or not Mr. Plummer received the market price for that which he had to sell. As to that, I think one has only to look at the matter from a purely commercial point of view—an immediate payment of £2,480 in return for five payments of £500 spread over five years—to appreciate at once that the discount for immediate payment is so slight (£20) as to constitute an extremely good bargain so far as Mr. Plummer was concerned. In my view, there can be no question but that he received “sufficient” consideration; it was obviously more than he could have hoped to obtain elsewhere. The curious point about the Special Commissioners’ findings is, however, that they have based the return to HOVAS on the unqualified assumption that it was going to be successful in obtaining a refund of tax. The still more curious position is that the Special Commissioners had earlier determined that HOVAS were unable to recover such tax. Even if this decision eventually turns out to be incorrect, it is obvious that the return to HOVAS was tinged with considerable qualifications, which are in no way reflected in the figures which the Special Commissioners accepted. Mr. Medd also sought to rely upon certain passages in the judgment in *Ball v. National & Grindlays Bank Ltd.*(1) 47 TC 287, which speak of “sufficient consideration” importing the giving of a “fair equivalent”. Applying that test, it is quite obvious from the mathematics I have already stated that Mr. Plummer did indeed obtain a fair equivalent. There is nothing in this point.

(IV) It was conceded by Mr. Nolan, for Mr. Plummer, that, apart from the decision in *Bulmer*(2), Mr. Medd would be bound to succeed on his fourth point, so I need say no more about it.

(V) So I come to what is really the whole nub of the present case; namely, so far as I am concerned, is it governed by *Bulmer*? What did that case decide? It was a case under what is now s 457, Income and Corporation Taxes Act 1970, in which a rather curious (but, in the event, wholly effective) scheme had been devised to enable the existing shareholders in a public company to acquire more shares in that company with a view to defeating a threatened take-over bid for the company. Extremely shortly put, the scheme involved the existing shareholders in selling their shares at a low price to a company specially incorporated for this purpose as a subsidiary of a friendly but wholly distinct company, and for the friendly company to lend money to this subsidiary at a commercial rate of interest. With this loan the subsidiary bought up additional shares in the market, and the dividends on all the shares were used, first, to service the loan and, secondly, to repay it. The shareholders had left the low purchase price of their shares outstanding as a loan. When the scheme was wound up they bought

(1) [1973] Ch 127. (2) 44 TC 1.

(Walton J.)

- A back the shares and all additional shares in such a manner that, apart from the interest which the friendly company had got on its loan to its subsidiary, the whole benefit accrued to the original shareholders. The Crown contended that these arrangements constituted a "settlement" within the meaning of the definition in what is now s 454(3), which I have already read. The taxpayers contended that it was not: that it was, on the contrary, a bona fide commercial arrangement. If it was not such an arrangement, what was it? The only other possibility open was that it was an arrangement under which the shareholders in effect caused their dividends to be piled up in the form of the additional shares in the company which accrued to them when the scheme came to an end—a very obvious tax-saving device. Now, having regard to the way in which the case was presented before the Special Commissioners, they had themselves made no finding as to the true nature of the scheme in this regard; and, in consequence, it was agreed between the Crown and the taxpayers that the High Court should make the necessary finding, based upon the primary facts as found by the Special Commissioners (see 44 TC, at page 29H). This explains the manner in which Counsel put the taxpayer's position at page 21E of the report: "That is why the test of commerciality is so important. If aimed at a tax advantage it would not have been a bona fide commercial transaction." In that case, this was the true dichotomy. The actual decision of Pennycuik J. was as follows⁽¹⁾:

- "It remains to be considered whether the scheme adopted by the Bulmer shareholders and Sanderson in the present case represented a bona fide commercial transaction. The Special Commissioners, naturally enough upon the course which the case took before them, did not make a finding upon this point. In order to avoid a remission, with further delay and expense, I accepted the invitation of both Counsel to make the necessary finding based upon the primary facts as found by the Special Commissioners. It seems to me abundantly clear that the transaction between the Appellants and Sanderson was indeed a bona fide commercial transaction. Again, in case that imports in any respect a different test, it is clear that there was no element of bounty as between the Appellants and Sanderson. Indeed, Mr. Goulding so concedes. To avoid misunderstanding, in the extraordinarily wide field covered by such words as 'agreement' and 'arrangement' one may well find a commercial transaction between A and B and then, built into that, so to speak, a transaction by way of bounty between A and C; but there is nothing of that kind here. The only conceivable element of undervalue in the case, to which Mr. Goulding rightly did not attach weight, was the low price paid by Yorkshire for the original shares, but this element loses almost all significance when one remembers, first, that the price was fixed so low at the instigation of Sanderson and, second, that the resulting debt was interest-free and fell to be set off against the price payable by the Appellants when their option to repurchase came to be exercised. Clearly the Appellants did not intend to confer a bounty either on Yorkshire or on Sanderson. It may be that the transaction has been framed—largely, it appears on the instigation of Sanderson—in such a way as to procure tax advantages to the Appellants, but that circumstance does not of itself prevent it from being a bona fide commercial transaction or import any element of bounty."
- I It is fair to say, I think, that he comes to no final conclusion as to whether the true test of a scheme which falls outside the definition of "settlement" is one which (a) is a bona fide commercial transaction or (b) is one in which there is no element of bounty. In *Bulmer* itself, both tests were satisfied.

(1) 44 TC 1, at pp 29–30.

(Walton J.)

Now in the present case (b) is undoubtedly satisfied, but what about (a)? A
Mr. Medd says that the principle of that case does not apply to a transaction the
sole purpose of which is tax avoidance. Russell L.J., in *Commissioners of Inland*
Revenue v. Goodwin(1) [1975] 1 WLR 640, said this, at page 647:

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

Although he was, I respectfully suggest, mistaken in his view of the *ratio* of
Bulmer’s case, he clearly indicates that in his view there can be a bona fide
commercial transaction with the obtaining of a tax advantage as a main object. C
Mr. Nolan says that this is really the case here, because in essence the sale of the
annuity was, save that the terms offered were rather better, of precisely the same
nature as if it had been sold to a purely commercial entity such as an insurance
company. It provided Mr. Plummer with a slice of capital in exchange for income.
And the Special Commissioners duly found as follows:

“We feel constrained by *Bulmer* . . . to proceed on the basis that neither D
s 434 nor s 457 applies to a bona fide commercial transaction without any
element of bounty. As in the HOVAS appeal it was common ground
between the parties that the transaction was carried out at arm’s length.
Mr. Plummer knew of no other organisation which would have been
prepared to purchase an annuity from him. From his point of view, if the E
tax advantages described by the brokers materialised, he would have laid
out his money to excellent advantage. We regard it as a fair description of
the transaction to say that it was a bona fide commercial transaction
without any element of bounty notwithstanding that the benefits from it
were largely to be derived from the tax advantages which the parties
expected would accrue to them.”

In my opinion, they were right to do so. I deprecate attempts to construe F
Pennycuick J.’s judgment in the *Bulmer* case as if it were providing some kind of
statutory exceptions to the statutory language, such exceptions then falling to be
construed themselves. If there is any distinction between the two tests, the idea
behind *Bulmer* and the cases which it followed is surely this: that, however wide
the statutory language in which the term “settlement” is defined, the overriding G
idea is that of bounty of some description. If there is no bounty, then there is
nothing which can even remotely be classed as a settlement with a settlor. If
HOVAS had been an ordinary commercial company, it is inconceivable that the
legislation would have been intended to bite; yet such must be the Crown’s
position. It would be still more inconceivable that the legislation would be
intended to bite the other way—for example, if a person purchases a short-term H
annuity from an insurance company, that the annuity would remain the income
of the insurance company and not that of the annuitant—and yet, once again,
this must be the logical outcome of the Crown’s position. Therefore, as in the
present case there is no question of bounty on either side, it appears to me quite
clear that the *Bulmer* principle applies as found by the Special Commissioners.

(1) 50 TC 583, at p 607. (2) 44 TC 1.

(Walton J.)

- A (VI) I can see no escape from the conclusion that the *Bulmer* principle⁽¹⁾ applies also to s 434. The wording of the respective definitions in ss 434(2) and 454(3) are quite indistinguishable. If, in the result, there is an element of tautology in s 434(1) in expressly excepting any disposition made for valuable and sufficient consideration, then so be it: as Mr. Nolan pointed out, there is often an element of tautology in taxing Statutes. And finally, as Mr. Nolan also pointed
- B out, the provisions of s 434 were consolidated by Parliament in the 1970 Act in Part XVI under the general heading of "Settlements" after, and therefore in the light of, the *Bulmer* decision.

For the foregoing reasons, therefore, I have come to the conclusion that the Crown's appeal in this case fails.

Appeal dismissed, with costs.

C

The Crown's appeal came before the Court of Appeal (Buckley and Bridge L.JJ. and Foster J.) on 4, 5 and 6 April 1978 when judgment was reserved. On 5 May 1978 judgment was given against the Crown, with costs.

Patrick Medd Q.C., Peter Gibson and Brian Davenport for the Crown.

Michael Nolan Q.C. and David Milne for the taxpayer.

- D The following cases were cited in argument in addition to those referred to in the judgment:—*Black Nominees Ltd. v. Nicol* 50 TC 229; *Commissioners of Inland Revenue v. Joiner* 50 TC 449; [1975] 1 WLR 1701; *Farrell v. Alexander* [1976] QB 345; *Commissioners of Inland Revenue v. Goodwin* 50 TC 583; [1975] 1 WLR 640.

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- E **Buckley L.J.**—This is an appeal from Walton J., who on 1 July 1977 dismissed an appeal by the present Appellants, the Commissioners of Inland Revenue, from a decision of the Special Commissioners for the Income Tax Acts, who had allowed appeals by the Respondent taxpayer, Mr. Plummer, against three assessments to tax in respect of the years 1970–71, 1971–72, 1972–73. The case involves considering the effect of an ingenious tax avoidance
- F scheme devised by Slater Walker Ltd. ("Slater Walker"), the objects of which were (1) to reduce the surtax liability of any surtax payer who availed himself of the scheme and (2) to enable a charitable body to build up a fund applicable for its charitable purposes by means of tax reclaimed from the Revenue in respect of five-year annuities sold by the surtax payers to the charity and paid
- G subject to deduction of tax, without in effect either the surtax payer or the charitable body having to find any cash from their own resources. The facts are set out in the Case Stated. It will be sufficient if I explain how the scheme worked in respect of the Respondent. At the relevant time the Respondent was employed as taxation manager by Slater Walker and acted in that capacity for the whole of the Slater Walker group of companies. It was part of his duties to ensure that the scheme to which I have referred worked efficiently. The Slater
- H Walker group included a company called Baldrene Ltd. ("Baldrene") of which

(1) 44 TC 1.

(Buckley L.J.)

the Respondent was a director, and also a company called Old Change Court (Investments) Ltd. ("OCC"). On 30 December 1970 Home and Overseas Voluntary Aid Services Ltd. ("HOVAS") was incorporated *ad hoc* for the purposes of the scheme. Its authorised and issued share capital was £10 divided into ten shares of £1 each. It was formed for charitable purposes and registered under the Charities Act 1960. It had a close business association with Slater Walker, but was not, as I understand it, one of the companies in the Slater Walker group. It has not been suggested that the personal relationship of the Respondent to Slater Walker or Baldrene has any bearing on this case. HOVAS, with the aid of moneys borrowed from Baldrene, held itself out as prepared to purchase annuities on terms attractive to persons who paid a high rate of surtax. Insurance and investment brokers named S. Cardale & Co. Ltd. ("Cardale") sought to interest clients in the scheme. The Respondent decided to take advantage of the scheme himself and approached Cardale accordingly. By 11 March 1971 negotiations were concluded under which the Respondent was to promise to pay to HOVAS for a period of five years or during the remainder of his life (if shorter) a yearly sum which would after deduction of income tax at the standard rate for the time being in force be equal to £500 in consideration of a price of £2,480 to be paid by HOVAS to him. On the same day HOVAS wrote to the Respondent confirming that HOVAS would accept as security for the yearly sum payable by the Respondent promissory notes to the value of £2,500 issued by OCC and a cheque for £300 to be invested in the Respondent's name in bank stock which he proposed to lodge with HOVAS as part of the security.

On 12 March 1971 the Respondent opened a banking account with Slater Walker, remitting £40 as an opening credit. He informed Slater Walker that they would be receiving £2,480 from HOVAS on 15 March 1971 to be credited to his account, following which Slater Walker should make the following payments out of the account, viz., £15 to Cardale (a fee for negotiating the agreement with HOVAS) and £2,500 to OCC in return for which OCC would issue ten promissory notes payable to bearer. The Respondent asked Slater Walker to accept the promissory notes and lodge them on his behalf with HOVAS as security for the due performance of his obligations under his agreement with HOVAS. He explained that, as his obligations were fulfilled, a proportion of the security given by him would be released and he requested and authorised Slater Walker to accept each release on his behalf. In the event of his account being overdrawn at the time of a release Slater Walker were to present an appropriate number of the notes to OCC for payment and to credit his account with the sums paid. The Respondent gave Slater Walker a standing order for payment out of the account of the five yearly sums of £500, the first to be paid on 29 March 1971.

On 15 March 1971, at a meeting referred to as the completion meeting, at which all parties concerned were present or represented, the Respondent entered into a written agreement with HOVAS (exhibit A 7 to the Case Stated) and a memorandum of agreement to deposit with HOVAS securities having a value equivalent to twice the aggregate amount of the net yearly sums due under the agreement or such other security as HOVAS should from time to time be prepared to accept to secure the due payment of the annual sums payable under the agreement. At the completion meeting HOVAS paid £2,480 to Slater Walker, which was credited to the Respondent's account with them. Slater Walker paid £15 to Cardale and £2,500 to OCC. OCC issued ten promissory notes to bearer payable on demand for an aggregate amount of £2,500. OCC

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- A entered into a written agreement with the Respondent to pay him interest on the amounts of the said notes at the rate of $6\frac{1}{2}$ per cent. per annum less income tax at the standard rate until demand for payment (exhibit A 10 to the Case Stated). Slater Walker lodged the notes with HOVAS. HOVAS in turn lodged the notes with Baldrene as part of the security for Baldrene's loan to HOVAS. The Respondent gave HOVAS a cheque for £300 and by way of further security assigned to HOVAS his right to interest under his agreement with OCC. The £300 was invested by HOVAS in the Respondent's name and the investment was retained by them as security as arranged. The Respondent signed five certificates of deduction of income tax pursuant to the Income and Corporation Taxes Act 1970, s 55, and handed these to Slater Walker with instructions to complete them on his behalf for use by HOVAS when claiming repayments of tax as and when each of the yearly sums was paid. All the documentation of these transactions was in standard pre-prepared forms. HOVAS for a small premium effected a life assurance policy covering the risk of the Respondent's death before 16 April 1975 in annually reducing amounts. The Respondent was 34 years of age at the time and in good health. In the agreement (exhibit A 7, which I shall call "the annuity agreement") the Respondent is described as "the annuity payer" and HOVAS is described as "the annuitant". Clause 1 of the agreement is in these terms:

"In consideration of the sum of £2,480 (hereinafter called 'the purchase price') now paid by the annuitant to the annuity payer (the receipt whereof the annuity payer hereby acknowledges) (a) the annuity payer hereby agrees to pay to the annuitant for the period of five years from the date hereof or during the remainder of the annuity payer's lifetime (whichever period shall be the shorter) an annuity (hereinafter called 'the annuity') at such rate as shall after deduction of income tax at the standard rate for the time being in force be equal to £500 per annum which annuity shall be payable in accordance with the provisions of Clause 2 hereof."

- E Paragraphs (b) and (c) of that clause relate to a warranty by the annuity payer concerning his age and medical history. Clause 2 reads:

"The first payment hereunder shall be made 14 days from the date hereof and subsequent payments hereunder shall be made on the anniversary of the first payment in each year during the continuance of this agreement each payment (if not paid on the due date) to carry interest at the rate of 18 per cent. per annum from the due date until payment". Clause 3 reads:

- G "Notwithstanding anything in the Apportionment Act 1870 the annuity payments hereunder shall only become payable on the due dates and shall not be deemed to accrue from day to day."

The memorandum of agreement to deposit was satisfied by the deposit with HOVAS of the promissory notes and the £300. The first payment under the annuity agreement was made on 29 March 1971 when Slater Walker debited the Respondent's account and credited the account of HOVAS with the sum of £500. The Respondent's account with Slater Walker thus went into overdraft. Promissory notes amounting to £500 in value were released by HOVAS on 31 March 1971 to Slater Walker and on the same date OCC, at Slater Walker's request, paid £500 into the Respondent's account with Slater Walker. The two days' delay between 29 March and 31 March 1971 was caused by the fact that the promissory notes lodged with HOVAS by the Respondent had been lodged by HOVAS with Baldrene as security for the moneys lent by Baldrene to HOVAS for the purchase of the Respondent's promise to make the yearly payments.

I

(Buckley L.J.)

Baldrene would not release any of its security until satisfied that its account had been effectively credited with an appropriate repayment. A precisely similar procedure was adopted on and after 29 March in each of the succeeding years under the annuity agreement. A

It will be appreciated that the purchase price paid by HOVAS for the five annual payments was borrowed from Baldrene, paid by HOVAS to Slater Walker for the account of the Respondent, and applied by Slater Walker at the direction of the Respondent in purchase of the promissory notes, which provided the security for the payment of the five annual sums and also for the loan by Baldrene to HOVAS. Apart from the small sum of £20, being the difference between £2,480 and £2,500, no cash had to be found by anyone other than Baldrene. It will also be appreciated that as each of the five annual payments was made, the Respondent paid £500 to HOVAS, HOVAS paid £500 to Baldrene, Baldrene released promissory notes to the value of £500 to HOVAS, HOVAS released the same notes to Slater Walker for the account of the Respondent and those notes were encashed, thus restoring the Respondent's account with Slater Walker to the state in which it was before he made the payment. The gross amount, equivalent to £500 net of income tax at the standard rate then in force, was £851.06. As each yearly payment was made HOVAS was provided with a certificate of deduction of tax and in due course claimed repayment of tax under the Income and Corporation Taxes Act 1970, s 360. The Commissioners of Inland Revenue, however, refused to admit such claims. HOVAS appealed against such refusal to the Special Commissioners, who dismissed the appeal. Although HOVAS required a Case to be stated under the Taxes Management Act 1970, s 56, for the opinion of the High Court, the appeal from that decision of the Special Commissioners has not been pursued. B C D E

The Respondent was assessed to surtax in the three years of assessment under appeal upon the footing that the annual payments which he made in those years under the annuity agreement were not deductible from his income for surtax purposes. He appealed against such assessments to the Special Commissioners contending (a) that the sum of £500 paid in each of the years under appeal was paid as an "annuity or other annual payment" and therefore fell to be deducted in computing his total income for surtax purposes; (b) that he was not under any legal obligation before 15 March 1971 to take or procure the taking of any of the steps taken at the completion meeting of that date; (c) that the said sums were paid for valuable and sufficient consideration and accordingly were not under the Income and Corporation Taxes Act 1970, s 434, to be deemed to be his income; (d) that, even if the said sums were not paid for valuable and sufficient consideration, the annuity agreement was a commercial transaction without any element of bounty and accordingly neither s 434 nor s 457 of the Income and Corporation Taxes Act 1970 applied so as to cause such sums to be deemed to be his income. F G

The Crown's contentions, stated shortly, were to the following effect: (a) that the proper conclusion on the facts was that the Respondent and HOVAS entered into a binding agreement at some time before 15 March 1971 to take all the steps eventually taken by each of them and that upon analysis the effect of such agreement was that the annual payments made by the Respondent were repayments of moneys lent to him by HOVAS and were therefore not payments of an income nature which would qualify for deduction in computing the H I

(Buckley L.J.)

- A Respondent's total income for tax purposes: (b) that, if contrary to (a) the annual payments had the quality of income, they were not made for valuable and sufficient consideration within the meaning of the Income and Corporation Taxes Act 1970, s 434(1), and so were to be deemed to be the income of the Respondent under that section; and that, in considering whether the payments were or were not made for valuable and sufficient consideration for the purposes of s 434, fiscal advantages were not to be taken into account, not being consideration moving from the promisee; (c) that bona fide commercial transactions without any element of bounty were not by implication excepted from s 434 and that in any event a transaction designed solely and primarily to obtain tax advantages was not a bona fide commercial transaction; (d) that, if s 434 did not apply, the payments were to be treated as the Respondent's income under s 457 of the same Act.

The Commissioners held that no contractual obligation to implement the scheme arose before 15 March 1971. They rejected the Crown's contention that the payment by HOVAS to the Respondent of £2,480 had the quality of a loan, and held that that payment was an outright payment to the Respondent in return for his promises under the annuity agreement and was not returnable to HOVAS either in whole or in part at any time. They treated the case as covered by *Sothorn-Smith v. Clancy*⁽¹⁾ 24 TC 1 and accordingly held that the sums paid by the Respondent under the annuity agreement were payments of an annuity or other annual payments and not repayments of a capital sum lent to him. The Commissioners were not satisfied that the consideration moving from HOVAS under the annuity agreement was sufficient for the purposes of s 434. They felt constrained by *Bulmer v. Commissioners of Inland Revenue*⁽²⁾ 44 TC 1 to proceed on the basis that neither s 434 nor s 457 applies to a bona fide commercial transaction without any element of bounty, and they held that this transaction was a bona fide commercial transaction without any element of bounty.

The Commissioners consequently allowed the appeal and discharged the first two assessments under appeal and reduced the third assessment to £3,349. The Crown asked for a Case to be stated and this in due course came before Walton J. The arguments before the learned Judge were similar to those before the Commissioners. Walton J. rejected the Crown's contention that the real nature of the Respondent's payments under the annuity agreement was that they were all capital payments, either as repayments of a loan or on some other basis. He also rejected a contention that the payments were not made out of profits or gains brought into charge to tax within the Income and Corporation Taxes Act 1970, s 52. He held that under the annuity agreement the Respondent had obtained a fair equivalent, that is to say, a sufficient consideration, for his obligations. Finally he held that *Bulmer v. Commissioners of Inland Revenue* applies to both s 434 and s 457. Before Walton J. the question whether *Bulmer v. Commissioners of Inland Revenue* was rightly decided was kept open for possible argument in this Court, but Mr. Medd has not suggested before us that that case was wrongly decided.

Where any annuity or other annual payment charged with tax under Case III of Schedule D (not being interest) is payable wholly out of profits or gains brought into charge to income tax, the payer bears tax at the standard rate on

(1) [1941] 1 KB 276. (2) [1967] Ch 145.

(Buckley L.J.)

the amount of the annual payment but is not liable for any surtax in respect of it (Income and Corporation Taxes Act 1970, ss 52(1) and 3(2)). He may, however, deduct tax at the standard rate from the amount paid to the recipient of the annual payment. It was under these provisions that the scheme was designed to benefit surtax payers who sold "annuities" to HOVAS. So the first question for consideration is whether the payments made by the Respondent under the annuity agreement were payments of an annuity or other annual payments within the meaning of those sections. Under Case III of Schedule D, which is to be found in s 109 of the Act, tax is charged in respect of any annuity or other annual payment payable as a personal debt or obligation by virtue of any contract. The five annual payments to be made by the Respondent under the annuity agreement were clearly annual payments payable under a personal debt or obligation of the Respondent by virtue of a contract, viz., the annuity agreement. Nevertheless they do not fall within the charge to tax if on the true view they are payments of capital (*Secretary of State for India v. Scoble*(1) [1903] AC 299); and see *Foley v. Fletcher* (1858) 3 H & N 769 and *Perrin v. Dickson*(2) [1930] 1 KB 107. If upon the true view of the facts the annual payments have the character of payments of capital, s 52(1) does not apply, even if they are made wholly out of profits or gains brought into charge to income tax. The fact that the payments are described in the annuity agreement as an "annuity" and that the parties are described as "the annuity payer" and "the annuitant" is not conclusive of the true character of the payments. The term "annuity" is not a term of art in our law. One has to look at the whole transaction to ascertain the true character of the payments (*Secretary of State for India v. Scoble* (*supra*); *Commissioners of Inland Revenue v. Wesleyan and General Assurance Society* 30 TC 11; *Commissioners of Inland Revenue v. Church Commissioners*(3) [1977] AC 329). In so doing one must pay due regard to the terms and legal effect of any formal legal documents employed. One may also have regard to extrinsic evidence, not to contradict the terms and effect of those formal legal documents, but to supplement them in throwing light on the true nature of the whole transaction (*Perrin v. Dickson* [1930] 1 KB 107, *Commissioners of Inland Revenue v. Church Commissioners* (*supra*)). If the transaction involves a series of preconceived steps, the performance of each of which is dependent on the others being carried out in accordance with a common intention of the parties, the nature and effect of the whole scheme may have to be taken into consideration in determining the nature of the annual payments (*Ransom v. Higgs*(4) 50 TC 1, *per* Lord Wilberforce at page 90 at A). If the true nature of the annual payments, so ascertained, is that they constitute repayment of an existing debt by annual instalments or payment of the purchase price of property by annual instalments, they will not, so far as the instalments constitute payment of principal, be chargeable to income tax, although to such extent, if any, as an instalment comprises an element of interest on principal, the instalment will be taxable (*Secretary of State for India v. Scoble* (*supra*); *Sothorn-Smith v. Clancy*(5), *per* Lord Greene M.R., at page 6). If the recipient is bound contractually or otherwise to apply the annual payments for capital purposes, the effect of the transaction may, and in my opinion almost certainly must, be such that the payments will not constitute income in the hands of the recipient and so will not be payable subject to deduction of tax by the payer (*Campbell v. Commissioners of Inland Revenue*(6) 45 TC 427). I may say that I am not at all sure that the author of the headnote to that report has correctly analysed the *rationes decidendi* of the learned Lords who decided that case.

(1) 4 TC 618.

(2) 14 TC 608.

(3) 50 TC 516.

(4) [1974] 1 WLR 1594.

(5) 24 TC 1.

(6) [1970] AC 77.

(Buckley L.J.)

- A Mr. Medd says that in consequence of the fact that the only purpose of the scheme was to secure tax advantages it is particularly incumbent on the Court in this case to look behind the way in which the transaction is dressed up to see what its true nature is. It is to be distinguished, he says, from a case in which the parties have some legitimate object which they wish to attain other than a mere fiscal advantage, for which purpose they have devised machinery
- B which will incidentally also produce the most satisfactory fiscal consequences. He has pointed out certain features which would be unusual in any ordinary case of a sale of an annuity such as (1) that the payer of the annuity was required by the scheme to secure due payment of it and to employ the whole purchase price in providing such security, (2) that the period of the annuity was not made dependant on the life of the purchaser or anyone whom he wished to benefit
- C but on the life of the annuity payer, and (3) that the purchaser insured the life of the annuity payer. I may say in passing that this last feature is obviously a consequence of or connected with the second feature. It was not stipulated in the annuity agreement nor, so far as I can see, was it in any other way a contractual feature of the scheme. The insurance was effected at the cost of HOVAS and was, it seems to me, a unilateral act on their part.
- D In support of his primary submission that the annual payments in this case were in truth payments of capital, Mr. Medd has emphasised the circular nature of the financial operations which, he says, were designed to ensure that HOVAS should get back by yearly instalments the whole of the sum paid by HOVAS to the Respondent. There seem to me to be two formidable objections to this view. First, the Respondent's primary obligation under the annuity agreement was
- E to pay in each year the gross amount of £851, amounting over the five years to much more than the £2,480 paid by HOVAS to the Respondent. The excess might perhaps be explicable as consideration for the loan and the arrangement for repayment over five years, but it is only if the Respondent was entitled to make the yearly payments subject to deduction of tax, which he could only do if the payments were not of a capital nature, that one achieves any coincidence
- F between the £2,480 and the aggregate amount of the five yearly payments, that is, £2,500. More significant, in my opinion, is the consideration that, if the Respondent had died after 15 March 1971 but before 29 March 1971, neither he nor his estate would have been liable to make any payment to HOVAS. This seems to me to be irreconcilable with the view that the £2,480 was paid to the Respondent by way of loan. If the yearly payments were not repayments of a
- G loan, I can see no other character that can be attributed to them except that of a fixed term annuity determinable on the death of the Respondent within five years. If that is what they are, as I think is the case, we are in my opinion bound by the decision in *Sothorn-Smith v. Clancy*⁽¹⁾ to hold that they are income payments: and see *Commissioners of Inland Revenue v. Church Commissioners*⁽²⁾ per Lord Wilberforce at page 340F.
- H Mr. Medd rightly, in my opinion, did not contend that in the present case HOVAS was bound to apply the yearly payments for capital purposes. Although it may be inferred from the Case Stated that HOVAS used each payment as it was received in making a payment of that amount to Baldrene in order to secure the release of £500 worth of promissory notes, there was no contractual obligation upon HOVAS to do so. They could have used any other available money
- I for this purpose and were no doubt in receipt of other like annual sums from annuity payers under the scheme which could have been so applied.

⁽¹⁾ 24 TC 1.⁽²⁾ [1977] AC 329; 50 TC 516, at p 565.

(Buckley L.J.)

So I am in agreement with the learned Judge in rejecting Mr. Medd's primary submission that on a true view of the transaction the yearly payments were, or were analogous to, repayments of a loan. The next question is whether they were payable wholly out of profits or gains brought into charge to income tax. It is conceded that, where a taxpayer has taxable income of a larger amount than the gross amount of any annuity or annual payments which he is obliged to make, he is entitled to be treated as having made such payments out of that income (see *Commissioners of Inland Revenue v. Frere*⁽¹⁾ 42 TC 125, per Viscount Radcliffe at page 148) unless the taxpayer has treated the payment as made out of capital in circumstances having practical results which are inconsistent with an attribution of the payments to his fund of taxed income (*Chancery Lane Safe Deposit and Offices Co. Ltd. v. Commissioners of Inland Revenue*⁽²⁾ 43 TC 83, particularly per Lord Morris at page 115 and per Lord Wilberforce at page 124). Mr. Medd submitted that the Respondent's account with Slater Walker was an account of capital moneys, being concerned only with capital receipts and payments. He says that the operations in that account were carefully segregated from all dealings with his taxed income. The learned Judge rejected this submission and in this respect also I agree with him. The Respondent was not bound to make the payments out of his account with Slater Walker nor was there any reason why he should not have fed that account from his fund of taxed income. It was clearly part of the scheme that the payments should be attributed to his taxed income and treated as paid thereout. In my judgment the Respondent did nothing which made it inappropriate for him to have the payments treated in this way.

The next question for consideration is the application to this case of the Income and Corporation Taxes Act 1970, ss 434 and 457. Both these sections are contained in Part 16 of the Act which is headed "Settlements". Section 434 is in Chapter 1 of that Part of the Act, which is headed "Dispositions for short periods", and s 457 is in Chapter 4, which is headed "Surtax liability of settlors in certain cases". By virtue of ss 459 and 454(3) "Settlement" in Chapter 4 includes any disposition, trust, covenant, agreement or arrangement. By virtue of s 434(2) "Disposition" in Chapter 1 includes any trust, covenant, agreement or arrangement. From the language of these sections it appears that the term "settlement" may be capable of a wider interpretation than the term "disposition". Section 434 expressly excludes from its operation any disposition made for valuable and sufficient consideration. Section 457 on the other hand contains no comparable exclusion. In *Bulmer v. Commissioners of Inland Revenue* 44 TC 1, however, Pennycuik J., applying earlier decisions of Lawrence J., in *Copeman v. Coleman*⁽³⁾ and Plowman J. in *Commissioners of Inland Revenue v. Leiner*⁽⁴⁾ held that a commercial transaction without any element of bounty could not constitute a "settlement" for the purposes of the Income Tax Act 1952, s 415(1), which was the predecessor of s 457(1) of the 1970 Act. At page 29F the learned Judge said:

"In the case of this definition, i.e. the definition of 'settlement', it must, I think, be at any rate legitimate to hold that a sufficient context exists for a restriction in the scope of the definition. Indeed, unless one implies some restriction, the definition, standing where it does in this Part of the Act, represents as odd a provision as one would anywhere find in a taxing Statute."

(1) [1965] AC 402.

(2) [1966] AC 85.

(3) 22 TC 594; [1939] 2 KB 484.

(4) 41 TC 589.

(Buckley L.J.)

- A It has not been suggested to us that that decision was wrong and for the purposes of the present appeal I assume it to have been right. Mr. Medd submitted that in using the word "commercial" Pennycuik J. intended to indicate that the transaction referred to must be one effected in the course of commerce or trading, which I take to mean one effected in the course of carrying on a business. I feel unable to accept this view, for it seems to me that the learned Judge was
- B not using the word "commercial" in so restricted a sense. In my judgment, the sale by a private individual, not in the course of his business, of his house to another individual who buys it for his private occupation is a commercial transaction in the proper sense of that term although it is not carried out in the course of carrying on any business or trade. In my opinion it is clear from the judgments of Pennycuik J. in *Bulmer v. Commissioners of Inland Revenue*⁽¹⁾ and of Plowman J. in *Commissioners of Inland Revenue v. Leiner*⁽²⁾ that those learned Judges were there using the term "commercial transaction" to indicate any transaction in which there was no element of bounty. It follows that a transaction effected for full consideration in money or money's worth is not a "settlement" for the purposes of s 457. The express exception contained in s 434 of "a disposition made for valuable and sufficient consideration" appears to me to have a similar effect. In *Ball v. National and Grindlays Bank Ltd.*⁽³⁾ 47 TC 287 Ungood-Thomas J., construing the words "valuable and sufficient consideration" in the Finance Act 1965, s 52(4)(b), said, at page 296:

- E "So in our case it seems to me that 'valuable and sufficient' must be given a meaning in this tax Statute independent of any common law reluctance to consider adequacy in consideration. It was submitted—rightly, in my view—that 'valuable' consideration is, as it so familiarly is in a legal context, in contrast with 'good' consideration, even though 'good' consideration might hardly relate to a corporation; and 'sufficient' goes to quantum in the sense of 'adequate', or, what doubtless comes to the same thing, 'fair equivalent'."

- F In the Court of Appeal Russell L.J. said, at page 299: "Now there is no problem as to the meaning of the word 'sufficient'; it connotes adequacy, an adequate *quid pro quo* of the liability incurred." So, in my judgment, it is also true to say that a transaction effected for full consideration in money or money's worth is not a "disposition" for the purposes of s 434. The transaction with which we are concerned was the sale of an annuity by the Respondent to HOVAS for a price in money. Was it, on the facts of the case, a transaction
- G which was devoid of any element of bounty? Should the price paid be regarded as full consideration? In sub-para 3(b) of their decision the Commissioners stated that they were not satisfied on the evidence before them that the consideration moving from HOVAS—that is to say, the purchase price—was sufficient consideration. They went on to explain their reason for this by a calculation of the interest which HOVAS would receive on its outlay. They made no positive
- H finding in this respect, but they did go on in the next sub-paragraph of the decision to find that it had been common ground between the parties that the transaction was carried out at arm's length. In the same paragraph they found that Mr. Plummer knew of no other organisation which would have been prepared to purchase an annuity from him, and that from his point of view, if the expected tax advantages materialised, he would have laid out his money to
- I excellent advantage. They said:

"We regard it as a fair description of the transaction to say that it was a bona fide commercial transaction without any element of bounty

(1) 44 TC 1.

(2) 41 TC 589.

(3) [1973] Ch 127.

(Buckley L.J.)

notwithstanding that the benefits from it were largely to be derived from the tax advantages which the parties expected would accrue to them.” A

Mr. Medd has contended that a transaction, the sole object of which is tax avoidance, cannot be a bona fide commercial transaction. Nowadays fiscal consequences are incidents of a very large number and variety of business transactions. These must inevitably affect the willingness of the parties to any transaction to enter into it. They must also necessarily affect the amount or value of the consideration which any party is willing to give or to accept in order to close a bargain. They must consequently be elements to be taken into account in determining whether the consideration given by either party is sufficient. In the present case both parties entered into the transaction in the anticipation that the Respondent would be able to deduct the annuity payments from his total income for surtax purposes and to pay the annuity subject to deduction of tax at the standard rate, and that HOVAS would be able to recover the tax so deducted. These were expected incidents of the transaction, and I can see no reason why the parties should have excluded them from consideration in negotiating the price which HOVAS was prepared to pay, and the Respondent was prepared to accept, for the annuity. It may be true that £2,480 would in other circumstances be a low price for the right to receive over five years gross sums amounting to £4,255, but HOVAS knew that the Respondent expected to be able to deduct tax at the standard rate and expected the transaction to afford him substantial surtax relief, so that, considering the sale of the annuity in isolation from the rest of the scheme, it would cost the Respondent much less on balance than £4,255 to provide the annuity. In the face of the finding that the negotiation was at arm's length it seems to me impossible to reach any other conclusion than that the price of £2,480 was full, and so sufficient, consideration for the purchase of the annuity, taking all the expected consequences into account. Indeed this seems to have been the Commissioners' own ultimate view having regard to their final conclusion that the transaction was a bona fide commercial transaction without any element of bounty. This is a finding of fact which could only be disturbed if it could be shown that it is insupportable on some ground of law. It appears to me that it was a finding which the Commissioners were fully entitled to make upon the basis that the transaction was negotiated at arm's length. The price of £2,480 was consequently presumably the lowest which HOVAS considered that they could reasonably hope to induce the Respondent to accept and the highest which the Respondent considered that he could reasonably expect to induce HOVAS to give. The fact that each party would have been influenced by fiscal considerations in reaching this decision does not in any way detract from the interest of each party to negotiate a price as advantageous as possible to that party. It is, in my opinion, quite fallacious to regard the fiscal advantages as constituting any part of the consideration for the bargain as Mr. Medd was inclined to do. They were incidents of the bargain and no more. The consideration was the purchase price on the one hand and the grant of the annuity on the other. B
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In these circumstances it would, I think, be wrong to read sub-para 3(b) of the Commissioners' decision as containing an inferential finding of fact that the consideration moving from HOVAS was insufficient consideration for the purposes of s 434. Had they made such a finding, I should regard it as a finding which could not be supported upon the Commissioners' own findings of primary fact. For these reasons I agree with the conclusion of the learned Judge that s 434 does not apply to the present case. For these reasons also I agree with his further conclusion that s 457 also does not apply to the present case. I

(Buckley L.J.)

- A In the concluding passage of his judgment Walton J. said that he could see no escape from the conclusion that the *Bulmer*⁽¹⁾ principle applied to s 434 as well as to s 457, notwithstanding that this might involve an element of tautology in s 434 in expressly excepting any disposition made for valuable and sufficient consideration. In my judgment the decision in *Bulmer* has no bearing upon s 434. The presence in s 434(1) of the exception of any disposition made for valuable and sufficient consideration, in my opinion, makes it unnecessary to imply in s 434 any such limitation on the meaning of "disposition" as was implied in *Bulmer* in respect of the meaning of "settlement" in s 457.
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For these reasons I would dismiss this appeal.

- Bridge L.J.**—I agree, and wish to add some words of my own only with reference to the application of s 434 of the Income and Corporation Taxes Act 1970. The effect of this section is that the annual payments by the Respondent to HOVAS under the annuity agreement are deemed to be the income of the Respondent and not of HOVAS unless the consideration moving from HOVAS was "sufficient". The relevant passage from the decision of the Special Commissioners reads:
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- D "As to the question whether the consideration moving from HOVAS was sufficient consideration for the purpose of the words in parenthesis in s 434(1), we were not satisfied on the evidence before us that it was. Mr. Plummer was aged 34 in March 1971 and was to receive £2,480 in return for gross payments, before deduction of tax, of some £4,255 over five years. As in the HOVAS appeal it was not suggested to us that the possible depreciation of money over the five years was a factor to be taken into account and we therefore ignore it. On this footing, assuming, as was the probability, that Mr. Plummer survived the period, HOVAS would receive the equivalent of compound interest at the rate of some 36 per cent. on its outlay assuming no undue delay in repayment of tax or 27 per cent. assuming a delay of one year, both yields being well in excess of yields of 6½ per cent. to 9 per cent. available in the market at the time."
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- F Walton J., having set out this passage, commented as follows⁽²⁾:

- G "I am afraid that, in this finding, the Special Commissioners have fallen into manifold errors. In the first place, they have asked themselves the wrong question. The question is not whether HOVAS made a bargain (if they did, which I shall examine later) but whether or not Mr. Plummer received the market price for that which he had to sell. As to that, I think one has only to look at the matter from a purely commercial point of view—an immediate payment of £2,480 in return for five payments of £500 spread over five years—to appreciate at once that the discount for immediate payment is so slight (£20) as to constitute an extremely good bargain so far as Mr. Plummer was concerned. In my view, there can be no question but that he received 'sufficient' consideration; it was obviously more than he could have hoped to obtain elsewhere."
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These two passages reveal a fundamental difference of approach in that the Special Commissioners ask whether the consideration was sufficient for the gross amount to be paid by the Respondent whereas the learned Judge takes the net amount after deduction of tax. The first approach shows the Respondent paying interest to HOVAS at an exorbitant rate, for which it would well be said

(1) 44 TC 1.

(2) Page 18 *ante*; [1977] 1 WLR 1227.

(Bridge L.J.)

that the consideration given by HOVAS was not sufficient. The second approach shows the Respondent paying over five years an aggregate sum to HOVAS which is only marginally in excess of the capital sum he receives at the outset; on this basis the consideration given by HOVAS is clearly ample. It seems to me, therefore, that we must decide which of these two approaches is correct. I was at first much impressed by the argument of Mr. Medd that one cannot, in deciding the sufficiency of consideration for the purposes of s 434, look at anything but the gross figures. He submits that to take the net figures after deduction of tax for this purpose is to assume the answer to the very question which falls to be decided, viz., whether the section applies and whether the gross payments will be eligible for deduction of tax. But Mr. Nolan has satisfied me that the effective counter to this argument is found in s 435. The effect of this section is that when s 434 applies to a disposition so that the income paid under it is deemed to be that of the payer he becomes entitled as against the payee to deduct from the payments the amount of the income tax chargeable on and paid by him in respect of the deemed income. It must follow from this that when a person is contemplating making a disposition to which s 434 may or may not apply according as to whether or not the consideration he receives is sufficient, he will know that in any event his liability will be limited to making the payment net of income tax at the basic rate. Accordingly this represents the commercial reality of the transaction and it must, in my judgment, be by reference to this commercial reality that the sufficiency of the consideration should be judged. I conclude that in the two passages quoted the approach of the learned Judge was correct and that of the Special Commissioners mistaken. For this reason in addition to the reasons given by Buckley L.J. I agree with Walton J.'s rejection of the Crown's argument that s 434 applied to the disposition in question. On all the other points canvassed I am in full agreement with the reasons given by Buckley L.J. for concluding that the appeal should be dismissed.

Foster J.—I agree with the judgment of Buckley L.J. and with the reasons which he gave.

Appeal dismissed, with costs. Leave to appeal to the House of Lords granted.

The Crown's appeal against the above decision came before the House of Lords (Lord Wilberforce, Viscount Dilhorne, Lords Diplock, Fraser of Tullybelton and Keith of Kinkel) on 19, 20 and 21 June 1979 when judgment was reserved. On 1 November 1979 judgment was given against the Crown, with costs (Viscount Dilhorne and Lord Diplock dissenting).

(1) *G. B. H. Dillon Q.C., Patrick Medd Q.C., Peter Gibson and Brian Davenport* for the Crown. First, a general observation. The nature and effect of the scheme as a whole has to be taken into account: see *Ransom v. Higgs*(2) [1974] 1 WLR 1594, 1612E-F, per Lord Wilberforce.

Four main issues of law arise in testing the efficacy of this scheme: (1) whether (as contended by the taxpayer) the sums paid by him under the agreement were payments of "any annuity or other annual payment", so that the amount of each payment could be deducted by him in computing his total income. If the taxpayer fails on this issue, none of the remaining issues arise;

(1) Argument reported by J. A. Griffiths Esq., Barrister-at-law. (2) 50 TC 1, at pp 90-91.

- A (2) whether such sums were payable by him wholly out of profits and gains brought into charge to income tax, (3) whether such payments were made otherwise than for valuable and sufficient consideration within the meaning of s 434 of the Income and Corporation Taxes Act 1970 ("the Act"); (4) whether such payments were income arising in consequence, or by virtue of, a "disposition" within s 434(1) of the Act as defined in s 434(2) thereof, or whether they were
- B income arising under a "settlement" within s 457 of the Act as those words are defined in s 454(3) of the Act. This issue raises the question whether the limitation attributed to the meaning of the word "settlement" in s 457 by Pennycuik J. in *Bulmer v. Commissioners of Inland Revenue*⁽¹⁾ [1967] Ch 145, should likewise be held to apply to the word "disposition" in s 434, and whether in either case the limitation on the meaning of the words had the effect of causing the
- C agreement in this case to be held not to be, respectively, a "settlement" or a "disposition".

The first two questions arise under s 52 of the Act. Are the payments of £500 each which the taxpayer made to HOVAS within the expression "annuity or other annual payment"? If so, were they payable wholly out of profits or gains brought into charge to income tax within s 52? "Payable" is not the same as "paid", though not necessarily different. Questions 3 and 4 which concern ss 434 and 457 of the Act are quite separate from questions 1 and 2 and questions 3 and 4 are separate from each other.

- (1) "Any annuity or other annual payment. . .". If the payments are of a capital nature they are not income in the hands of the recipient and not deductible in the hands of the payer. The Court has to look at the surrounding
- E facts admitting extrinsic evidence to ascertain what was the real nature of the payment: see *Commissioners of Inland Revenue v. Church Commissioners for England*⁽²⁾ [1977] AC 329. In considering whether a capital sum has been used in the purchase of an annuity the test has been whether the capital sum has gone and has been replaced by an income: *Foley v. Fletcher* (1858) 3 H & N 769, 784-785, per Watson B. See also *Perrin v. Dickson*⁽³⁾ [1929] 2 KB 85; [1930] 1
- F KB 107, 114 *et seq.*, 121 *et seq.*, 124, 127, and *Sothorn-Smith v. Clancy*⁽⁴⁾ [1941] 1 KB 276, 282 *et seq.*, 288, 289, where all three members of the Court of Appeal commenting on *Perrin v. Dickson* [1930] 1 KB 107, applied Watson B.'s test. In the present case the capital sum paid by HOVAS is not lost sight of. It has been borrowed by HOVAS from Baldrene. The £2,480 was provided for the taxpayer to enable him to pay the annuity. It is emphasised that in the present
- G case the capital is never lost sight of for the annual payments were paid by the taxpayer out of the price that he has received and the above test ought to be applied in that the payments were of a capital and not of an income nature.

- (2) Whether the sums paid each year by the taxpayer were properly to be regarded as having been paid wholly out of profits and gains brought into charge to income tax within the meaning of s 52 of the Act. The classic exposition of
- H what is meant by the words "payable out of profits or gains brought into charge to income tax" and of the basis upon which the deduction of an annual payment is allowed, if the payment is within s 52 of the Act and there is no provision in the income tax Acts disallowing it, is to be found in the opinion of Viscount Radcliffe in *Commissioners of Inland Revenue v. Frere*⁽⁵⁾ [1965] AC 402, 419, with which all other members of this House agreed. The basis for the deduction
- I is that under s 52 the payer may deduct and retain the tax paid on the amount

(1) 44 TC 1. (2) 50 TC 516. (3) 14 TC 608, at pp 619, 624, 627 and 629.

(4) 24 TC 1, at pp 6, 9-10. (5) 42 TC 125, at pp 147-8.

of the annuity or annual payment which is treated as not being part of his income but that of the recipient. *Prima facie*, if a taxpayer is found to have, in the relevant year, taxable income larger than the gross amount paid as an annuity he is entitled to say that he made the payment out of the profits and gains brought into charge to income tax. A

It has long been recognised that there are exceptions to the above proposition. Thus in *Chancery Lane Safe Deposit and Offices Co. Ltd. v. Commissioners of Inland Revenue*⁽¹⁾ [1966] AC 85, 131, it was recognised by Lord Wilberforce that the taxpayer loses the right of allocation if he has made a decision which has practical results inconsistent with the actual claim to attribute the payment to taxed profits. True, that case concerned a corporation, the relevant case concerning an individual taxpayer is *Fenton's Trustee v. Commissioners of Inland Revenue*⁽²⁾ [1936] 2 KB 59, where the facts are closely analogous to the transaction in question here. *Fenton* governs the present case and the judgment of Romer L.J. was right. The reasoning in the judgment of Lord Wright M.R. is in line with that of Romer L.J. The dissenting judgment of Greene L.J. was in substance repeated in *Allchin v. Coulthard* [1942] 2 KB 228, and the judgment of Greene L.J. in *Allchin* was approved in this House [1943] AC 607. But in *Allchin v. Coulthard* [1942] 2 KB 228, Greene L.J. did not refer to what he said in *Fenton's Trustee v. Commissioners of Inland Revenue* [1936] 2 KB 59, 89, that the exemptions only apply to companies and not individuals for this point did not arise on the facts of *Allchin v. Coulthard*. There is nothing in what this House stated in *Allchin v. Coulthard* [1943] AC 607 which is contrary to what Romer L.J. and Lord Wright M.R. said in *Fenton's Trustee v. Commissioners of Inland Revenue* [1936] 2 KB 59. In *Chancery Lane Safe Deposit and Offices Co. Ltd. v. Commissioners of Inland Revenue* [1966] AC 85, Lord Morris of Borth-y-Gest, Lord Wilberforce and Lord Pearson all refer to *Fenton's Trustee v. Commissioners of Inland Revenue* [1936] 2 KB 59, but there is nothing in the *Chancery Lane* case which is inconsistent with what was stated in the majority judgments in *Fenton's Trustee v. Commissioners of Inland Revenue* was rightly decided and should be applied to the present question. B
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In the present case the yearly payments of £500 were made out of the taxpayer's special account with Slater Walker Ltd. which account contained only capital sums, namely the £2,480 received from HOVAS and the yearly proceeds of the promissory notes together with £40 paid in by him to cover the charge made by Cardale for negotiating the agreement and the cost of insuring his life. In an ordinary case, having paid the annuity out of a capital fund he would, if he wished to maintain his capital, have had to pay into the fund (that is in this case the Slater Walker Ltd. bank account) an equivalent sum from his income but in this case because of the way in which the scheme worked, it is not necessary for the taxpayer to repay this capital payment from his income. The depletion of his capital was immediately made good by the release to him of another capital sum, namely, £500, the proceeds of the promissory note. Thus it is true both in fact and in principle that the payments were not made out of the profits and gains brought into charge to income tax. G
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(3) Whether the payments were made otherwise than for valuable and sufficient consideration within the meaning of s 434 of the Act. The taxpayer has always conceded that unless the limitation on the definition of "settlement" laid down in *Bulmer v. Commissioners of Inland Revenue*⁽³⁾ [1967] Ch 145, applied equally to the definition of "disposition" in s 434, the agreement, being an agreement or covenant, was a disposition within the meaning of the section. I

(1) 43 TC 83, at p 124. (2) 21 TC 626. (3) 44 TC 1.

- A Moreover, that the payments made under it were payable or applicable for the benefit of a person (namely HOVAS) other than the taxpayer and were so payable or applicable for a period which could not exceed six years. Accordingly, unless (a) "disposition" in s 434 is to be given a similar limited meaning to that of "settlement", or (b) the agreement was one made by the taxpayer for valuable and sufficient consideration, the payments made by him under the agreement
- B fall within the section, and he would not be entitled to deduct the amount of them in computing his total income from all sources. It is (a) which has now become of primary importance on this question and it follows in the circumstances that if the gloss given to the word "settlement" by *Bulmer v. Commissioners of Inland Revenue*⁽¹⁾ [1967] Ch 145 applied to s 434 then questions 3 and 4 are linked.
- C (4) Whether the payments made under the agreement were income arising in consequence, or by virtue, of a "disposition" within s 434(1) of the Act as defined in s 434(2) or whether they were income arising out of a "settlement" within s 457 of the Act as those words are defined in s 454(3) of the Act. The language of s 457 makes it necessary to refer to the definition of "settlement" in s 453 which is similar to the definition, save in one respect, to that found in s 444. There is no room for the application of the *eiusdem generis* rule to an interpretation provision: *Hood Barrs v. Commissioners of Inland Revenue* 27 TC 385; *Thomas v. Marshall*⁽²⁾ [1953] AC 543. In *Bulmer v. Commissioners of Inland Revenue* [1967] Ch 145 Pennycuick J. held that a series of transactions which were bona fide commercial transactions and contained no element of bounty did not constitute a "settlement" within the meaning of what is now s 454(3) of the Income and Corporation Taxes Act 1970. It was held that where the context so requires the court may imply some restriction upon the scope of general words in a statute; and that in the case of the definition of "settlement" it was legitimate to hold that a sufficient context existed for the restriction in the scope of the definition. In these circumstances it was held on the basis of certain observations in *Commissioners of Inland Revenue v. Leiner* 41 TC 589 and *Copeman v. Coleman*⁽³⁾ [1939] 2 KB 484 that the "arrangement" which was the subject of decision in *Bulmer* was not a "settlement" within the section because it was a bona fide commercial transaction containing no element of bounty. The Crown do not dispute that *Bulmer v. Commissioners of Inland Revenue* [1967] Ch 145 was correctly decided on its facts for it is accepted that some limitation must be imposed on the very wide literal meaning of the word "settlement" given to it by the interpretation provision in s 454(3). But it cannot have been intended by the Legislature when enacting a section specifically aimed at tax avoidance that the word "settlement" should be so limited as to except from the provisions of the section a transaction such as the present of which the sole purpose was tax avoidance. The Crown do not accept the conclusion that has been drawn from *Bulmer* by Walton J. and the Court of Appeal in the present case. Given that some limitation on the meaning of the word "settlement" is necessary to effect the intention of the Legislature it is important to see which side of the boundary particular cases fall. The boundary should be drawn in such a way as not to take out of the provisions of the section a transaction whose only purpose is the avoidance of tax. *Bulmer v. Commissioners of Inland Revenue* was not such a case and the judgment does not support the proposition that had Pennycuick J. been considering a case such as the present he would have held that there was not a settlement. The Crown accept that when a genuine commercial transaction is to be carried out and there are two ways of carrying it out—one by paying the maximum amount of tax, the other by paying none, or much less tax, it is legitimate for commercial men to adopt the method
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(1) 44 TC 1. (2) 34 TC 178. (3) 22 TC 594.

by which less tax is paid. When such a course is adopted it may well be right in some circumstances to call such transactions "bona fide commercial" transactions. But it would be a mis-use of language to describe the present transaction as "commercial". There is all the difference between a bona fide commercial transaction which involves a tax advantage and that type of transaction which has been described as a "planned raid on the Revenue". See *Finsbury Securities Ltd. v. Bishop*⁽¹⁾ [1966] 1 WLR 1402 and *Lupton v. F.A. & A.B. Ltd.*⁽²⁾ [1972] AC 634.

Medd Q.C. following. On the approach to the annuity problem, all the words in question are ordinary English words and therefore should be given their ordinary meaning: see *Hinton v. Maden & Ireland, Ltd.*⁽³⁾ [1959] 1 WLR 875, 885, per Lord Reid. There are two further principles which are relevant: (a) What the parties call the transaction is not conclusive: *Secretary of State in Council of India v. Scoble*⁽⁴⁾ [1903] AC 299; *Ridge Securities Ltd. v. Commissioners of Inland Revenue*⁽⁵⁾ [1964] 1 WLR 479. (b) A transaction entered into with the motive of obtaining a tax advantage does not make the transaction *ipso facto* not a trading transaction: *Commissioners of Inland Revenue v. Wesleyan & General Assurance Society*⁽⁶⁾ [1946] 2 All ER 749, 751, per Lord Greene M.R. See also *Lupton v. F.A. & A.B. Ltd.*⁽⁷⁾ [1972] AC 634, 644D, per Lord Morris of Borth-y-Gest;⁽⁸⁾ 647, 657, per Viscount Dilhorne;⁽⁹⁾ 658, 660, per Lord Donovan. That approach can be applied in the present case. Reliance is also placed on the observations of Lord Donovan in *Campbell v. Commissioners of Inland Revenue*⁽¹⁰⁾ [1970] AC 77, 110, in relation to the approach to be adopted in determining whether the payment in question was an annuity. Here as in *Campbell* the question is not answered by the document alone; it is necessary to look at the other evidence. The present is a case of a person who wished to make payments to another person but he did not wish to make such payments out of his own pocket, that is, out of his own spendable income and therefore he had to receive moneys from that other person first. This is not merely a strange type of annuity but the transaction is so strange that it ceases to be an annuity at all. The present transaction is analogous to the illustration given by Lord Morris of Borth-y-Gest in *Lupton v. F.A. & A.B. Ltd.*⁽¹¹⁾ [1972] AC 634, 645.

Michael Nolan Q.C., *R. S. Alexander Q.C.* and *David Milne* for the taxpayer.

[Lord Wilberforce stated that their Lordships desired to hear argument primarily on the fourth issue.]

As to the fourth issue, bounty is the test to be applied in this part of the Act, which is concerned with settlements. A settlement connotes bounty. Sections 435, 441 and 449 which transfer the tax bounty to the recipient are only intelligible if confined to bountiful transactions. If one moves out of the field of bounty then one has to find other criteria. It was said by the Crown that the present transaction was one of tax avoidance. But in none of the cases, which are many, relating to settlements has this point been raised. There is no difference in commercial terms between this transaction and the sale of an annuity payable under the settlement to those companies which buy such annuities. In the present case there were practical benefits apart from the avoidance of tax. Thus the taxpayer obtained £2,480. If he died during the currency of the agreement his estate would have benefitted provided he did so before all the annual payments had been made. The settlement provisions in the Act nowhere bring in

(1) 43 TC 591. (2) 47 TC 580. (3) 38 TC 391, at p 413. (4) 4 TC 478, 618. (5) 44 TC 373.

(6) 30 TC 11, at p 16. (7) 47 TC 580, at p 617. (8) *Ibid*, at pp 620 and 628.

(9) *Ibid*, at pp 629 and 631. (10) 45 TC 427, at p 473. (11) 47 TC 580, at p 618.

- A motive. They are to be contrasted in this respect with ss 460 and 478. The contention that s 457 applies to arm's length transactions is not supported by the authorities and entails reading words into the Act. It is assumed in passages in the speech of Lord MacMillan in *Chamberlain v. Commissioners of Inland Revenue*⁽¹⁾ [1943] 2 All ER 200, 204, that this legislation only applies to gifts. As to *Bulmer v. Commissioners of Inland Revenue*⁽²⁾ [1967] Ch 145, it is
- B to be observed that the expression "bona fide commercial transaction" is not to be found in the Act. The Crown state that Parliament must have been expected to spare the well-intentioned. What is meant by "bona fide" in this connection? Does the expression bona fide commercial transaction exclude the benefit of obtaining a tax advantage? The taxpayers adopt the words of Russell L.J. in *Commissioners of Inland Revenue v. Goodwin*⁽³⁾ [1975] 1 WLR 640, 647: "*Bulmer v. Commissioners of Inland Revenue* [1967] Ch. 145 was a case indicating that the expression 'bona fide commercial transaction' was used judicially to describe something lacking an element of bounty, in determining whether there was a 'settlement' . . . it indicates, as one would expect, that there can be a bona fide commercial transaction with the obtaining of a tax advantage as a main object."
- C

- D In the present case the Special Commissioners state as a finding of fact that the present transaction was a bona fide commercial transaction. The Special Commissioners are in a unique position to decide what is a bona fide commercial transaction. There is no need for the law to invent a *mens rea* test for this provision. The Crown's construction of s 457 leads to a cutting across of the provisions relating to settlements. As to (3), the definition of "settlement" in s 457 is the same as that of "disposition" in s 434. This is a disposition containing no element of bounty and therefore is not a disposition within the meaning of the Act. This whole fasisculus of sections relates to gifts and on that interpretation there is no difficulty. As to the expression "valuable and sufficient consideration" in s 434, the taxpayer obtained valuable and sufficient consideration in the circumstances for his disposition: see *per* Walton J.⁽⁴⁾ [1977] 1 WLR 1227, 1238d.
- E
- F

- On questions (1) and (2), there are powerful arguments that can be adduced against the Crown's contentions. If the taxpayer had died on 16 March 1971, plainly the money would have gone to his estate and not returned to HOVAS. As to whether there was here an annuity, this was an income payment. It was not part of any capital sum. Here there was nothing in the payments by the taxpayer which were repayments of any capital sum. The present case is wholly different from *Perrin v. Dickson*⁽⁵⁾ [1929] 2 KB 85 where the whole of the capital sum was to be returned to the company. Reliance is placed on the observations of Lord Greene M.R. in *Sothorn-Smith v. Clancy*⁽⁶⁾ [1941] 1 KB 276, 282. From early days of tax legislation it has not been disputed that an annuity can be bought for a lump sum and that it will be purely income in the purchaser's
- G hands: see *Commissioners of Inland Revenue v. Church Commissioners for England*⁽⁷⁾ [1977] AC 329, 340, 341, *per* Lord Wilberforce.
- H

- On the meaning of the words in s 52, "wholly out of profits or gains brought into charge to income tax", Lord Wright M.R.'s observations thereon in *Fenton's Trustee v. Commissioners of Inland Revenue*⁽⁸⁾ [1936] 2 KB 59, 66 *et seq.*, are inconsistent with what Lord Greene said in *Allchin v. Coulthard* [1942] 2 KB 228 whose judgment was approved in this House [1943] AC 607. [Reference was also made to *Crossland v. Hawkins*⁽⁹⁾ [1961] Ch 537 and *Chinn v. Hochstrasser*⁽¹⁰⁾ [1979] Ch 410.]
- I

(1) 25 TC 317, at p 331. (2) 44 TC 1. (3) 50 TC 583, at p 607. (4) Page 18 *ante*.

(5) 14 TC 608. (6) 24 TC 1, at pp 6-7. (7) 50 TC 516, at pp 565-6.

(8) 21 TC 626, at p 637. (9) 39 TC 493. (10) TC Leaflet 2817.

Alexander Q.C. following. It is common ground that “settlement” has a wide general meaning and must be read subject to some limitations. The limitations suggested have been in terms of bounty or that of a bona fide commercial transaction. The concept of bounty is the correct test. If bounty be the test then the Crown concede that in the present case there is no element of bounty. Buckley L.J.⁽¹⁾ [1979] Ch 63, 79H–80B adopted the right approach to what constitutes a bona fide commercial transaction. If bona fide commercial transaction be the test then the Crown contend that if the sole purpose of the present transaction was tax avoidance this was neither bona fide nor a commercial transaction. But see the observations of Russell L.J. in *Commissioners of Inland Revenue v. Goodwin*⁽²⁾ [1975] 1 WLR 640, 647. The House is asked to reject the contention put forward by the Crown in para 34 of their printed case. The concession there contained does not go far enough. There can be a bona fide commercial transaction albeit a main purpose of it is to obtain a fiscal advantage, for example, the single premium pension payment made by the self-employed person. The Crown seek to construe s 457 as a general anti-tax avoidance section, but it cannot be so construed.

Dillon Q.C. in reply. On question (4), it was said that the Crown’s construction leads to a cutting across other provisions of the Act of 1970. But there are various sections in that Act where there is a choice of charging section. The bounty test is wrong. The words of s 457 are quite general. The observations of Lord Greene in *Hood Barrs v. Commissioners of Inland Revenue* 27 TC 385, 399 *et seq.*, assist the Crown. Further in *Yates v. Starkie*⁽³⁾ [1951] Ch 45 where there was an order by the Divorce Court for the taxpayer to make payments annually to his three children it was held that although there was there no act of bounty nevertheless the payments constituted a settlement for present purposes. As to question (1), in *Sothorn-Smith v. Clancy*⁽⁴⁾ [1941] 1 KB 276 the Court of Appeal was applying the same test as that propounded in *Perrin v. Dickson*⁽⁵⁾ [1929] 2 KB 85 which in its turn was applying that propounded by Watson B. over a century ago in *Foley v. Fletcher* 3 H & N 769, namely, has the capital sum disappeared and been replaced by an income? In the present case it is plain beyond peradventure that the capital sum has not disappeared. The capital sum goes round in a circle. It does not cease to exist and therefore these are not annual payments of an income nature.

Nolan Q.C. in rejoinder. There is nothing in Lord Greene’s judgment in *Hood Barrs v. Commissioners of Inland Revenue* 27 TC 385, to suggest that he was concerned with anything apart from acts of bounty.

The following cases were cited in argument in addition to those referred to in the speeches:—*Commissioners of Inland Revenue v. Frere* 42 TC 125; [1965] AC 402; *Finsbury Securities Ltd. v. Bishop* 43 TC 591; [1966] 1 WLR 1402; *Campbell v. Commissioners of Inland Revenue* 45 TC 427; [1970] AC 77; *Chinn v. Collins* TC Leaflet 2717; [1979] Ch 447.

Lord Wilberforce—My Lords, this case arises out of a “tax saving scheme” devised by a firm of insurance and investment brokers. They sent out to a number of persons thought likely to be interested, under the heading “Most Confidential”, details of what they called a “Capital Income Plan”. The general nature of this was to enable taxpayers paying income tax at a high marginal

(1) Page 29 *ante*. (2) 50 TC 583, at p 608. (3) 32 TC 38.

(4) 24 TC 1. (5) 14 TC 608.

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A rate to turn some of this income into capital, while, conversely, enabling a non income-taxpayer (viz., a charity) to convert some capital into income. Operations of this general description are quite common, and legal; indeed many investors in annuities or in insurance policies do just this in the normal course of prudent investment. This particular operation is perhaps an extreme case.

B The plan now involved was explained by the brokers in great detail, and its intended accomplishment set out, with timetables, in almost military precision. This (as I ventured to suggest in *Commissioners of Inland Revenue v. Church Commissioners for England*⁽¹⁾ [1977] AC 329) entitles and requires us to look at the plan as a whole. It does not entitle us to disregard the legal form and nature of the transactions carried out. It was not suggested that any part of the plan as executed was a sham—indeed the Special Commissioners found to the contrary. It is entitled to a fair, if not a particularly benevolent, analysis. The Respondent decided to enter into the plan in a modest way. By an annuity agreement made on 15 March 1971 with Home and Overseas Voluntary Aid Services Ltd. (“HOVAS”), a body with charitable status, he agreed, in consideration of £2,480 paid by HOVAS, to pay HOVAS for five years, or the lesser duration of his life, an annual sum of such an amount as after deduction of income tax at the standard rate for the time being would equal £500. This amounted in fact to £851.06. HOVAS paid £2,480 to an account which the Respondent had opened shortly before, with a credit of £40, with Slater Walker Ltd. The Respondent had instructed Slater Walker Ltd. when they received the £2,480 to pay £15 to the brokers as their fee and to pay £2,500 to Old Change Court (Investments) Ltd.—“OCC”—a company in the Slater Walker group, in exchange for five promissory notes of £500 each. These notes were then to be lodged with HOVAS as security for payment of the annual sums, and were to be released as the Respondent paid the latter. OCC agreed to pay interest at 6½ per cent. on the amounts of the notes. There were further arrangements involving the borrowing by HOVAS of the money they needed in order to pay the capital sum, and insurance of the Respondent’s life which I need not detail: they are neutral as regards the issues under consideration. What happened thereafter was that the Respondent, by means of a standing order on Slater Walker Ltd., paid the annual sums to HOVAS on overdraft, which was liquidated a few days later by the release of a promissory note. The Respondent signed each year and sent to HOVAS the usual certificate as to deduction of tax and HOVAS applied for the repayment of this tax. But this part of the plan miscarried: the Inland Revenue refused to make the refund and on appeal to the Special Commissioners their refusal was upheld. HOVAS has not taken the matter further. Then the Respondent claimed to deduct the amount of each payment as an “annuity or other annual payment” in computing his total income for surtax purposes. This claim has succeeded before the Special Commissioners and in both Courts below. In the Courts the plan has been subjected to a four-way attack.

I 1. The first is based upon the terms of s 52 of the Income and Corporation Taxes Act 1970 which opens with the words “Where any annuity or other annual payment charged with tax under Case III of Schedule D . . .” Then the maker of the payment is entitled to deduct tax at the standard rate. It is common ground that these words cover, and cover only, payments having the character of income and do not cover capital payments even if made annually. The argument for the Crown was that the payments of £500 per annum made by the Respondent were in reality capital payments and not payments having the

(1) 50 TC 516.

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character of income. In the Courts below this argument took the form of a contention that the £2,480 was paid to the Respondent by way of loan and that the "annuity" payments were nothing other than repayments of this loan. This argument having been rejected (rightly in my opinion) in both Courts, the Crown presented a reconstructed form. This, as I understood it, was that the payments represented nothing but a repayment to HOVAS of its own capital. While it may be true that an annuity bought for a capital sum has the character of income, and while there was such an annuity in this case, it was said that the concomitant arrangements, in particular the arrangements for security, changed the character of the payments. The capital sum of £2,480 paid by HOVAS remained in existence—in the form of promissory notes—and it was this sum, in that form, which was paid back to HOVAS. HOVAS instead of receiving an annuity was simply receiving back its own capital in instalments.

My Lords, if it were possible to disregard the legal form of the documents and to look behind them for an underlying substance, there would be attractions—beyond those of ingenuity—in this argument. But I do not find it possible to do this. The classic analysis of this type of transaction is the judgment of Sir Wilfred Greene M.R. in *Sothorn-Smith v. Clancy*(¹) [1941] 1 KB 276. There, on the facts, there was a strong case for saying that the annuitant or the annuitant plus the named recipient was simply receiving his capital back. But the Court of Appeal would not have this. Sir Wilfred Greene M.R. thought that there could be much to be said for regarding a purchase of an annuity for a term of years as being one for purchase of instalments consisting mainly of capital and partly of interest, but did not feel himself at liberty to adopt any such principle. "I feel bound to regard the purchase of an annuity of the kind to which I have referred as the purchase of an income and the whole of the income so purchased as a profit or gain notwithstanding the way in which the payments were made" (page 285). If this is the general rule, is there anything in the present case which causes it not to apply? In my opinion there is not. The £2,480 when paid became the property of the Respondent. It remained his property none the less though he invested it, plus £20, in promissory notes and deposited them by way of security. He became entitled to release of a portion of it each year as he paid the annuity, each portion coming to him with interest: at the end of the five years he had received the whole, with interest. During the five years the Respondent had a right—a limited one it is true—to select the manner in which the money should be invested.

Looked at from the other side, HOVAS's right was to receive an annual sum under covenant. If the Respondent did not pay, they could sue him on his covenant. There was no identity between the amount they paid and that which they might receive back. In the first place the sums they were entitled to were the gross amount of the "annuity" which, assuming that the value remained unchanged, would be five times £85 10s 6d, i.e. £4,255.30 subject, or not, to tax at the standard rate. In the second place, if the Respondent died during the five years they would receive from the Respondent only those annuity payments which he made during his life. (In addition they would recover something on the insurance policy they took out.) Such rights as they might have over the promissory notes were rights by way of security only. In short, unless we are prepared to disregard the legal structure of these transactions, their nature is clear: a covenant, for capital sum, to make annual payments, coupled with security arrangements for the payments. But no attack was made on the transactions as a sham and we must accept the consequences of them.

(¹) 24 TC 1, at p 7.

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- A** 2. The second argument arises also out of s 52(1)(c) (*ubi supra*) which, if the payer of an annual sum is to be entitled to deduct and retain income tax on it, requires the annual payments to be payable wholly out of profits or gains brought in to charge to income tax. It is not disputed that the Respondent had in each relevant year sufficient taxed income to cover the payments. What is said is that the Respondent in fact made the payments out of the moneys
- B** provided by the promissory notes, which were not taxed income, or, if this is not accurate, out of an overdraft provided by Slater Walker which was fed by the proceeds of the promissory notes. My Lords, upon the authorities which have dealt with this difficult branch of income tax law, the position as regards this taxpayer is clear. The general rule, in the case of an individual at least, is that what is significant, when one is considering the application of the statutory
- C** rule, is not the actual source out of which the money is paid, nor even the way in which the taxpayer for his own purposes keeps his accounts, if indeed he keeps any, but the status of a notional account between himself and the Revenue. He is entitled, in respect of any tax year, to set down on one side his taxed income and on the other the amount of the annual payments he has made and if the latter is equal to or less than the former, to claim the benefit of the section.
- D** To this general rule some exceptions have recently been introduced and explained at length in this House—see *Central London Railway Co. v. Commissioners of Inland Revenue*(¹) [1937] AC 77 and *Chancery Lane Safe Deposit and Offices Co. Ltd. v. Commissioners of Inland Revenue*(²) [1966] AC 85. Very briefly and summarily these apply—so that the taxpayer cannot claim the benefit of the section—(*inter alia*) if he has treated the payments in accounts in
- E** such a way as to produce consequences inconsistent with their being treated as income. The above two cases are both cases of corporations, which are limited by law and by their own “vires” as to the preparation of their accounts and their treatment of income in a way in which individuals are not limited. Whether an individual by his conduct may prevent himself from preparing his notional account with the Revenue has not, I think, been the subject of reliable decision.
- F** The case of *Fenton’s Trustee v. Commissioners of Inland Revenue*(³) [1936] 2 KB 59 is sometimes relied upon by the Crown as an authority on this point, and though not invoked in the Courts below, was deployed in this House: I hope that this may be for the last time. The appeal was made to the judgment of Romer L.J.—and that of Lord Wright was to the same effect—that if a payment of interest is made out of money borrowed for the purpose of paying it, and is
- G** then added to the amount of the capital borrowed, the taxpayer is to be treated as having made an election which precludes him from taking the benefit of the section (then s 36 of the Income Tax Act 1918). But, in my opinion, the judgments of Lord Wright M.R. and Romer L.J. in that case, from which Greene L.J. dissented, can no longer be considered to state the law. Greene L.J. restated his opinion (which in any event I would find unanswerable) in *Allchin v. Coulthard*(⁴)
- H** [1942] 2 KB 228 and that judgment in turn was approved by this House [1943] AC 607 and again in the *Chancery Lane* case (*ubi supra*): it has now become established doctrine. On this view of the law, the position is clear. The Respondent here did nothing (even assuming that he could have done anything) to prevent himself from claiming the benefit of the section. On the contrary, the whole nature of the plan involved him in an intention to make the payments
- I** out of income and if he had drawn up any accounts he would have shown them as so paid. The manner in which he chose to provide the cash—itself open to modification at any time—is completely irrelevant. In my opinion this argument fails.

(1) 20 TC 102.

(2) 43 TC 83.

(3) 21 TC 626.

(4) 25 TC 445.

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3. This argument arises under s 434(1) of the Income and Corporation Taxes Act 1970 which, in the case of payments made for a period which cannot exceed six years, deems income to be the income of the payer unless made for valuable and sufficient consideration. On this point the Special Commissioners were in favour of the Crown. But Walton J. in his judgment effectively demonstrated, in my opinion, that they had fallen into error on the mathematics, and, further, that there was no ground for holding that the consideration for the payments was not valuable and sufficient. The Court of Appeal agreed and I do not find it necessary to do more than to accept their reasoning.

4. The final argument for the Crown arises under s 457 of the Income and Corporation Taxes Act 1970:

“Where, during the life of the settlor, income arising under a settlement made on or after 7th April 1965 is, under the settlement and in the events that occur, payable to or applicable for the benefit of any person other than the settlor, then, unless, under the settlement and in the said events, the income either” [and then there is a whole list of matters, none of which applies here] “the income shall be treated for the purposes of surtax as the income of the settlor and not as the income of any other person.”

The applicable definition of a “settlement” is to be found in s 454(3): it is “any disposition, trust, covenant, agreement or arrangement”. It is not disputed that if the agreement in this case (of 15 March 1971) was a “settlement” within this definition, s 457 would apply and the income, i.e. the annuity payments, would be treated as the income of the settlor, i.e. of the Respondent and not as the income of any other person. This raises a question of some difficulty and general importance. Are the words of the definition to be given the full unrestricted meaning which apparently they have, or is some limitation to be read into them, and if so what limitation? If given the full unrestricted meaning, the section would clearly cover the present agreement, and would also cover a large number of ordinary commercial transactions. My Lords, it seems to me to be clear that it is not possible to read into the definition an exception in favour of commercial transactions whether with or without the epithet “ordinary” or “bona fide”. To do so would be legislation, not interpretation: if Parliament had intended such an exception it could and must have expressed it. But it still becomes necessary to enquire what is the scope of the words “settlement” and “settlor” and of the words which are included in “settlement” in the context in which they appear. If it appears, on the one hand, that a completely literal reading of the relevant words would so widely extend the reach of the section that no agreement of whatever character fell outside it, but that, on the other hand, a legislative purpose can be discerned, of a more limited character, which Parliament can reasonably be supposed to have intended, and that the words used fairly admit of such a meaning as to give effect to that purpose, it would be legitimate, indeed necessary, for the courts to adopt such a meaning.

Part XVI of the Act of 1970, which includes ss 434 to 459 is headed “Settlements”. It includes a number of provisions which have been enacted at different times, the general effect of which is to cause income of which a person has disposed in various ways to be treated, in spite of the disposition, as the income of the disposer. These had been successively enacted in the Finance Acts 1922, 1936, 1938, 1946 (*inter alia*) with increasing severity. Chapter I of Part XVI is headed “Dispositions for Short Periods”: exempting dispositions for valuable and sufficient consideration, it treats dispositions of income for a period which

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- A cannot exceed six years as the income of the disponent. Chapter II deals with settlements on children—the general purpose being to prevent (i.e. to tax if they are made) dispositions the effect of which is to spread income among the children of a settlor. This chapter has its own definition of “settlement” as “any disposition, trust, covenant, agreement, arrangement or transfer of assets”. Chapter III deals with revocable settlements, settlements in which a settlor retains an interest and capital payments made to a settlor or his spouse, the effect of which is to tax income from which a settlor, or his wife, may benefit as the settlor’s income. The definition of “settlement” (s 454(3)) is that which I have quoted as applicable in the present case. Lastly Chapter IV, headed “Surtax Liability of Settlers in Certain Cases” contains (briefly) a broad sweeping-up provision for taxing any income of a settlement except income from property of which the settlor has divested himself absolutely by the settlement. The definition of “settlement” (s 459) is that which I have quoted.

- My Lords, it can, I think, fairly be seen that all of these provisions, in Part XVI, have a common character. They are designed to bring within the net of taxation dispositions of various kinds, in favour of a settlor’s spouse, or children, or of charities, cases, in popular terminology, in which a taxpayer gives away a portion of his income, or of his assets, to such persons, or for such periods, or subject to such conditions, that Parliament considers it right to continue to treat such income, or income of the assets, as still the settlor’s income. These sections, in other words, though drafted in wide, and increasingly wider language, are nevertheless dealing with a limited field—one far narrower than the field of the totality of dispositions, or arrangements, or agreements, which a man may make in the course of his life. Is there then any common description which can be applied to this?

- The courts which, inevitably, have had to face this problem, have selected the element of “bounty” as a necessary common characteristic of all the “settlements” which Parliament has in mind. The decisions are tentative, but all point in this direction. The first clear indication of this was given by Lord Macmillan in *Chamberlain v. Commissioners of Inland Revenue*⁽¹⁾ [1943] 2 All ER 200. Dealing with a case arising under the predecessor of s 447 of the Act of 1970 he said that he agreed that the settlement or arrangement

- “must be one whereby the settlor charges certain property of his with rights in favour of others . . . it must confer the income of the comprised property on others, for it is this income so given to others that is to be treated as, nevertheless, the income of the settlor.” (page 204).

- [I do not think that this passage is affected by the observations of Lord Greene M.R. in *Hood Barrs v. Commissioners of Inland Revenue* 27 TC 385.] In *Commissioners of Inland Revenue v. Leiner* 41 TC 589, at page 596, Plowman J. said that it was common ground—i.e. accepted by the Crown—that “it is implicit in the fasciculus of sections of which [Chapter II of Part XVI of the Act of 1970] forms a part that some element of bounty is necessary to make the sections apply . . .” and this point was made explicit by Pennycuik J. in *Bulmer v. Commissioners of Inland Revenue*⁽²⁾ [1967] Ch 145. Dealing with a case under the predecessor of Chapter III of Part XVI of the Act of 1970 he followed the previous cases in holding that a sufficient context existed for a restriction in the scope of the definition and that he accepted the “element of bounty” test. My Lords, I think that in so doing the learned Judge was well

(1) 25 TC 317, at p 331. (2) 44 TC 1.

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within the limits of permissible interpretation, and that with the “element of bounty” test we have a definition which is in agreement with the intention of Parliament as revealed through the whole miniature code of Chapter XVI. I would compare with this the reasons of this House in *Thomas v. Marshall*⁽¹⁾ [1953] AC 543. In that case the contention was that the word “settlement” did not extend to an outright gift. Their Lordships rejected this, holding that the intention was clearly to enlarge the meaning of settlement so as to include gifts. Enlargement in one direction and restriction in another are both part of a balanced process of judicial interpretation directed towards implementing but not exceeding the general legislative purpose. My Lords, there cannot be any doubt that in this case no element of bounty existed. The Special Commissioners indeed said that they regarded the transaction as a bona fide commercial transaction without any element of bounty. The taxpayer therefore succeeds on this point.

One final point: the familiar argument was used that Parliament can never have intended to exempt from the taxing provisions an arrangement solely designed to obtain fiscal advantages. But this is not the question, nor is a canon of interpretation of this kind admissible—or indeed a workable canon. The question is whether a certain series of transactions in a certain legal form do or do not fall within the taxing words. If they do not, and if Parliament dislikes the consequence, it can change the law—as in fact it has done since the scheme in question was operated. The subject is entitled to be judged under the law as it stood at the relevant time.

I would dismiss the appeal.

Viscount Dilhorne—My Lords, in this appeal we are concerned with an ingenious, complicated and well thought out scheme which had two objects, first, as the Special Commissioners found, to reduce the surtax liability of payers of a high rate of surtax, and secondly, to build up a tax free fund in a company called Home and Overseas Voluntary Aid Services Ltd. (“HOVAS”) by that company securing payment by the Inland Revenue of sums equivalent to those deducted by the individual participants in the scheme on their making annual payments to HOVAS. It was, to adapt the words of Lord Donovan in *Lupton v. F.A. & A.B. Ltd.*⁽²⁾ [1972] AC 634, at page 657, a scheme to avoid the payment of tax by those who participated and to raid the Treasury using the technicalities of revenue law as the necessary weapon. It was called the “Capital Income Plan” and details of it were sent in a letter marked “Most Confidential” to a number of people by S. Cardale & Co. Ltd. (“Cardale”), insurance and investment brokers. Although in some minor respects there were departures from the scheme in the case of the Respondent, as the letter states very clearly what was involved, I propose to cite its relevant parts. It reads as follows:

“Most Confidential. Capital Income Plan. 1. Situation. Mr. X has a taxable income of £30,000 a year. The following example assumes that, in addition to Income Tax at the standard rate, the top £14,694 of this income suffers surtax @ 10/- in the £: i.e. £7,347.2. Investment plan. (a) A Charity purchases an Annuity from Mr. X at a Purchase Price of say £44,800. The exact Purchase Price will depend on his age and health. (b) In return, Mr. X agrees to pay the Charity five net annual payments of £9,000 (i.e. a gross sum

(1) 34 TC 178. (2) 47 TC 580, at p 629.

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- A of £14,694 before deduction of Income Tax @ 7/9 in the £). (c) The Charity requires a guarantee that Mr. X will make his annual payments as agreed. To effect this, with the £44,800 received from the Charity, Mr. X purchases Promissory Notes for a total value of £45,000 from a reputable Finance Company. The difference between the Purchase Price (£44,800) and the cost of the Promissory Notes (£45,000) must be found by Mr. X: i.e. £200.
- B The Promissory Notes are payable over the five years—£9,000 each year on the same day each year. These notes are accepted by the Charity by way of guarantee. Further security is required as the total value of security must be worth a minimum of 110% of the net Unpaid Annuities (not including the first Annuity payment).
- C 3. Operation. (a) On the day Mr. X signs his Annuity Agreement, he is required to take the following action:—
 1. Open a Deposit Account with a Merchant Bank and deposit say £15 in this account. 2. Pay stamp duty of £73 to the Inland Revenue based on the gross amount of the annual payment. 3. Pay an amount equal to 5% of the Purchase Price (£2,240) by way of initial charge. 4. On receipt of the Purchase Price (£44,800), purchase Promissory Notes for £45,000 which are lodged with the Charity. The Promissory Notes will earn interest at 6½% per annum. 5. Deposit Short Dated Gilt Edged Securities equivalent in value to 10% (a minimum of 15% in the case of acceptable equities) of four net annual payments $10\% \times (4 \times £9,000) = £3,600$. (b) Twenty eight days after receiving the Purchase Price, Mr. X makes his first payment of £9,000 to the Charity which releases the same amount to him from the Promissory Notes a day later. Overdraft facilities will be available for this one day. (c) The Promissory Notes are repaid to Mr. X as he pays his future annual payments. At the same time, any security surplus to the requirements of the Charity is available for release to Mr. X. (d) If Mr. X should die at any time before making his final payment, no further payment is due. All remaining Promissory Notes are converted into cash at par and this is released to his Estate with any interest due together with all additional security. 4. Result. (a) The gross equivalent of the £9,000 a year is £14,694. Mr. X deducts this latter sum each year in computing his total income for Surtax. With Surtax at 10/- in the £ his annual saving is £7,347. (b) On the basis that Mr. X survives the five years and fulfils all his commitments, his estimated final position is:—

| | £ | Benefit | £ |
|----------------|-------|--------------------|--------|
| G Cost | | | |
| Initial Charge | 2,240 | Surtax Saving | |
| | | (5 × £7,347) | 36,735 |
| Cash | 200 | Net Interest | |
| Stamp Duty | 73 | (Promissory Notes) | 683 |
| | 2,513 | | 37,412 |

- H His profit on the transaction is thus £34,905 Free of Tax.”

This so-called profit is, it will be appreciated, the amount of tax Mr. X will avoid less the cost of participating in the scheme.

- I The charity concerned was HOVAS, a company incorporated on 30 December 1970 with an authorised share capital of £10 and at all material times an issued share capital of 10 shares of £1 each. It was registered as a charity. On 10 March 1971 HOVAS borrowed from a company called Baldrene Ltd. £1,430,000 with interest at 12 per cent. At that time bank rate stood at 6½ per cent. Baldrene was a company in the Slater Walker group and the Respondent was one of its directors. At all material times he was employed as

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taxation manager by Slater Walker Ltd., and he acted in that capacity for the whole of the Slater Walker group. One of his duties was to ensure the efficient working of the capital income plan. HOVAS held itself out as prepared to buy annuities on terms attractive to payers of a high rate of surtax, the money borrowed from Baldrene being available for the purpose. A

The Respondent decided to participate in the scheme and on 9 March 1971 Cardale wrote to him telling him that HOVAS had agreed to purchase an annuity from him and that their charge for negotiating the contract would be 5 per cent. of the purchase price of the annuity. Later they reduced this to £15. On 11 March HOVAS wrote to the Respondent telling him that they would accept as security for the payment of the net annuity payments outstanding of £2,500 promissory notes to that value and a cheque for £300 to be used for the purchase of Midland Bank Ltd. ordinary stock. The next day the Respondent wrote to Slater Walker Ltd. asking them to open an account in his name and enclosing a cheque for £40 for the credit of his account. He told them that on 15 March they would receive a cheque for £2,480 from HOVAS, which they did, and that it was to be credited to his account and that as soon as it was received, they were to pay £15 to Cardale and £2,500 to Old Change Court (Investments) Ltd. ("OCC") and for that sum that company, also one of the Slater Walker group, would issue to him ten promissory notes payable to bearer which they were to lodge with HOVAS as security for the due performance of his obligations under the annuity agreement. He told them that as his obligations under that agreement were fulfilled, a proportion of the security given by him would be released and that if at any time when a release of any promissory note was made to them his account was overdrawn, they were to present the note as soon as possible to OCC and to credit the sums paid by OCC to his account. The same day, 12 March, he gave Slater Walker Ltd. a standing order for the payment of £500 to HOVAS on 29 March 1971 and annually on that date up to and including 19 March 1975 or until the order was cancelled. B C D E

On 15 March the annuity agreement was entered into. Under it in consideration for the payment of £2,480 by HOVAS he undertook to pay that company for five years or during the remainder of his life, whichever should be the shorter, an annuity "at such rate as shall after deduction of income tax at the standard rate for the time being in force be equal to £500 per annum . . ." He also warranted to HOVAS that statements made by him to the Royal Insurance Co. for the purpose of enabling HOVAS to insure his life were true and that he had made full disclosure of all material information and he agreed to indemnify them should that not prove to be the case and they suffered loss or damage in consequence. HOVAS insured his life until 16 April 1975 for a premium of £16.97. On 15 March the Respondent also wrote to HOVAS saying that he had authorised Slater Walker to deposit with them ten promissory notes of the value of £2,500. HOVAS in turn lodged the notes with Baldrene as part security for the money they had borrowed from that company. OCC agreed to pay 6½ per cent. interest less tax on the outstanding notes and the Respondent assigned that interest to HOVAS to hold as security for the fulfilment of his obligations. The same day he sent to Slater Walker Nominees a cheque for £300 and asked HOVAS to purchase with that sum equities acceptable to them as security. He also sent five forms which he had signed but not completed to Slater Walker Ltd. and asked them to complete them as the annual payments were made and to send each completed form to HOVAS. Each form would then show the sum alleged to have been deducted on the payment of each £500. F G H I

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- A It will be noted that under the arrangements made by the Respondent there were minor departures from the capital income plan outlined in Cardale's letter, the most important of them being the insurance of the Respondent's life for five years by HOVAS. Five annual payments amounting in total to £2,500 were to be paid to HOVAS in return for the payment by them of £2,480, the difference between the two figures presumably being to make provision for the payment
- B by the Respondent of the life insurance premium. The effect of these operations was that this part of the money borrowed by HOVAS from Baldrene never passed out of the control of the Slater Walker group. It was a term of the arrangements made by the Respondent with HOVAS that on receipt of the purchase price, it would be used with the addition of £20 to buy promissory notes of a total value of £2,500 from OCC. It was a stipulation in the capital
- C income plan that the purchase money should be applied in the purchase of promissory notes. £2,500 was so used and the notes were lodged with HOVAS and by them with Baldrene as part security for the loan from Baldrene to HOVAS. It may be that the Respondent could have bought the notes with other moneys but that would have been a departure from the capital income plan and his arrangements with HOVAS. When the time came for payment of
- D an annual payment it was paid out of his account with Slater Walker Ltd. and the temporary overdraft that created would be discharged by the release by Baldrene to HOVAS and by them to Slater Walker Ltd. of promissory notes to the value of £500 which were presented for payment by Slater Walker to OCC and paid.

- E The cost to the Respondent was consequently the £15 paid to Cardale, the £20 to cover the payment of the insurance premium on his life and a small amount of interest on the overdrafts. If the scheme worked, he would as a result be relieved of a considerable liability for surtax. The cost to HOVAS was the interest at 12 per cent. payable to Baldrene. If they succeeded in obtaining a refund from the Revenue of the amount deducted by the Respondent from the annual payments, they would, the Special Commissioners found, receive a
- F return the equivalent of compound interest at the rate of some 36 per cent. on their outlay, assuming no undue delay in repayment of tax or 27 per cent. assuming a delay of one year; and at the end of the five years they would have received back the £2,480 credited to the Respondent and £20. On various dates between its incorporation on 30 December 1970 and 30 March 1971
- G HOVAS entered into similar transactions with 40 individuals. HOVAS's income and expenditure account for the period 30 December 1970 to 5 April 1972 showed an income of £954,982.45 of which £919,461.65 represented "Annuities (Gross)" and their expenditure during that period showed that they had spent on "Charitable Work" £19.55.

- H In these circumstances it is hardly surprising that the Crown should challenge the Respondent's right to deduct tax from the annual payments of £500 and HOVAS's right to obtain payment from them of the amount deducted. Before the Special Commissioners, Walton J. and the Court of Appeal, they were not successful. They, however, succeeded in resisting HOVAS's claim for a refund on the ground that that company had not applied its income for charitable purposes only. From the Special Commissioners' decision HOVAS has not appealed.

- I The Crown contended: (1) that the payments to HOVAS were not payments of an annuity or other annual payment, with the consequence that the Respondent was not entitled to deduct therefrom tax at the standard rate; (2) that the

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sums were not payable by him out of profits or gains brought into charge to income tax; (3) that s 434 of the Income and Corporation Taxes Act 1970 applies as the payments were not made for valuable and sufficient consideration; and (4) that s 457 of that Act applies with the consequence that for the purposes of surtax the payments were to be treated as the income of the Respondent. It will, I think, be convenient to consider the fourth contention first.

Does s 457 apply? So far as material that section reads as follows:

“457.—(1) Where, during the life of the settlor, income arising under a settlement made on or after 7th April 1965 is, under the settlement and in the events that occur, payable to or applicable for the benefit of any person other than the settlor, then, unless, under the settlement and in the said events, the income either—... (e) is income, which by virtue of some provision of the Income Tax Acts not contained in this Chapter, is to be treated for the purposes of those Acts as income of the settlor, the income shall be treated for the purposes of surtax as the income of the settlor and not as the income of any other person.”

This section is the first section of Chapter IV of the Act, headed “Surtax Liability of Settlers in Certain Cases” and s 459 of this Chapter states that “in this Chapter . . . ‘settlement’ and ‘settlor’ have the meanings assigned to them for the purposes of Chapter III” by s 454. Section 454(3) provides that “‘settlement, includes any disposition, trust, covenant, agreement or arrangement, and ‘settlor’, in relation to a settlement, means any person by whom the settlement was made”. This definition of “settlement” and “settlor” is the same as that in s 41(4)(b) of the Finance Act 1938 and corresponds with that in s 21(9)(b) of the Finance Act 1936 save that in the latter Act the definition includes the words “transfers of assets”.

In *Chamberlain v. Commissioners of Inland Revenue*(¹) [1943] 2 All ER 200 Lord Macmillan accepted the view that: “the statutory expansion of the term ‘settlement’” [in s 41] “which includes an ‘arrangement’ justifies and, indeed, requires a broad application”, and then added: “but a settlement or arrangement to come within the statute must still be of the type which the language of the section contemplates.” These observations were considered by Lord Greene M.R. in *Hood Barrs v. Commissioners of Inland Revenue* 27 TC 385, at page 402. He rejected the argument that Lord Macmillan had meant that to come within the statute a settlement or arrangement must be of the type which the word “settlement” in the section contemplated. He thought that Lord Macmillan’s proposition said no more than what was obvious, namely: “You never construe a word in a statute, whether it be in the body of the statute or in an interpretation clause, without reference to the context in which it appears.” In *Bulmer v. Commissioners of Inland Revenue*(²) [1967] Ch 145 Pennycuik J., at page 165, said that unless one implied some restriction to the width of the definition, it “represents as odd a provision as one would anywhere find in a taxing statute”.

It cannot, in my opinion, be right for the courts to amend the definition by adding words to it limiting its scope. That would be legislating. On the other hand, it is open to the courts when considering particular transactions and whether they come within the definition, to conclude that Parliament cannot

(¹) 25 TC 317, at p 331. (²) 44 TC 1, at p 29.

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- A have intended that they should be treated as doing so; and to decide, if that conclusion is reached, that they do not. There must be a number of cases in which it cannot have been the intention of Parliament that income transferred to another pursuant to an agreement or arrangement should nevertheless continue to be treated as the income of the transferor. In *Copeman v. Coleman*⁽¹⁾ [1939] 2 KB 484 Lawrence J. held that there was a disposition or an arrangement in the nature of a disposition coming within s 21 of the Finance Act 1936. In the course of his judgment he said that what had been done was not a bona fide commercial transaction. In *Commissioners of Inland Revenue v. Leiner* 41 TC 589 it was common ground that it was implicit in Chapter II of the Income Tax Act 1952 dealing with "Settlements on Children" that some element of bounty was necessary to make the sections in the Chapter apply and that a bona fide commercial transaction would be excluded from them. For this latter proposition *Copeman v. Coleman* was cited. In *Bulmer v. Commissioners of Inland Revenue*⁽²⁾ (*supra*) Pennycuik J. followed what was said in these two cases. He held that the transaction he had to consider was a bona fide commercial transaction and that there was no element of bounty and so he allowed the taxpayer's appeal.

- D My Lords, if Parliament had intended that the definition in s 454(3) should only apply to a settlement, a disposition, trust, covenant, agreement or arrangement in which there was an element of bounty, that could easily have been stated. Similarly if Parliament intended that despite the width of the definition, bona fide commercial transactions should be excluded, that also could easily have been stated. For my part I decline to construe the definition as if it contained these words. It may well be that in a great many cases there will be an element of bounty but to hold, when Parliament has not so enacted, that s 457 only applies when there is an element of bounty may be to restrict its operation far beyond Parliament's intention—and the width of the definition is a clear indication that its scope was intended to be wide. What exactly is comprehended in the phrase culled from Lawrence J.'s judgment "a bona fide commercial transaction", I do not know. "Bona fide" means, I suppose, that it was not a sham. A wide variety of transactions may be called commercial transactions. As my noble and learned friend Lord Russell of Killowen said in *Commissioners of Inland Revenue v. Goodwin*⁽³⁾ [1975] 1 WLR 640, at page 647: "there can be a bona fide commercial transaction with the obtaining of a tax advantage as a main object." (Emphasis supplied.)

- G My Lords, the Income and Corporation Taxes Act 1970 must be construed like any other Act and in my opinion the right approach to construing s 457 and the definition is to consider first, whether in its ordinary natural meaning the language of these provisions applies to the matters under consideration; and then, if it does, to consider whether or not Parliament can have intended that the transactions in question should come within their scope.

- H In the present case Mr. Nolan for the Respondent conceded in the Court of Appeal that s 457 applied apart from the decision in *Bulmer v. Commissioners of Inland Revenue*. I do not, for the reasons I have stated, consider that decision prevents the section from applying. That there are some who carry on the business of devising schemes for tax avoidance is well known. Their activities may well be described as commercial. The question to be decided is whether
- I Parliament can have intended that the arrangement of which *the* main object

(1) 22 TC 594. (2) 44 TC 1. (3) 50 TC 583, at p 607.

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was the obtaining of tax advantages should be outside the operation of s 457. A
 In my opinion the answer is in the negative and so the answer to the question
 "Does s 457 apply?" is yes, if the payments of £500 a year are to be regarded as
 income, a subject to which I shall return later.

I now turn to the Crown's third contention and the question: *Does s 434*
apply?

That section reads as follows: B

"434.—(1) Any income which, by virtue or in consequence of any
 disposition made, directly or indirectly, by any person (other than a
 disposition made for valuable and sufficient consideration), is payable to
 or applicable for the benefit of any other person for a period which cannot
 exceed six years shall be deemed for all the purposes of the Income Tax
 Acts to be the income of the person, if living, by whom the disposition was C
 made, and not to be the income of any other person. (2) In this Chapter,
 unless the context otherwise requires, 'disposition' includes any trust,
 covenant, agreement or arrangement."

While in my opinion a court can conclude that a disposition, trust, covenant,
 agreement or arrangement which *prima facie* is one to which the section applies,
 is not one to which Parliament can have intended it to apply, as I see no grounds D
 for such a conclusion in this case, the section applies unless the disposition,
 agreement or arrangement was made for valuable and sufficient consideration.
 The Special Commissioners were not satisfied that it was, saying that the
 Respondent was to receive £2,480 in return for gross payments before deduction
 of tax of some £4,255 over five years. Walton J. and the Court of Appeal did
 not agree. I agree with them. HOVAS in return for £2,480 were to receive in E
 the five years £2,500 in circumstances in which they hoped to recover from the
 Revenue the difference between the grossed up equivalent of £500 before
 deduction of income tax at the standard rate, i.e. in March 1971 £351.06. The
 only money which notionally or actually would be paid by the Respondent
 over the five years was £2,500 and for that he had £2,480 credited to his bank
 account. If the payments of £500 are properly to be regarded as income payable F
 to HOVAS, a question to which I shall come later, the arrangement or agreement
 to pay those sums was in my opinion made for valuable and sufficient considera-
 tion. The answer, therefore, to this question is in my view that s 434 does not
 apply.

I now turn to the Crown's first two contentions which can conveniently
 be considered together. The questions to be answered are: (1) *Were the payments* G
to HOVAS payments of an annuity or other annual payment coming within s 52
of the Income and Corporation Taxes Act 1970? and (2) *if so, were they payable*
wholly out of profits or gains brought into charge to income tax? If the answers
 to these questions are in the affirmative, then the section provides that no
 assessment to income tax, other than surtax, is to be made on the recipient of
 the annuity or annual payment and that the payer is entitled to deduct and H
 retain a sum representing the amount of income tax thereon at the standard rate.

The section begins as follows: "52.—(1) Where any annuity or other annual
 payment charged with tax under Case III of Schedule D . . . is payable wholly
 out of profits or gains brought into charge to income tax . . ." Payments charged

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- A with income tax under Case III are payments of income. Profits or gains brought into charge to income tax must also be income. So is it the case that the payments of £500 were income in the hands of HOVAS and were payable wholly out of income of the Respondent?

- The £2,480 paid into the Respondent's bank account was clearly a payment of a capital nature. The difference between that and the value of the promissory notes bought was obviously to secure that the Respondent paid for the insurance of his life. Did HOVAS thereby secure an income for themselves for five years or was each payment a repayment of part of the capital they had expended? In considering this question one is entitled to have regard to all the arrangements made and not only to the document called the annuity agreement. (See *Commissioners of Inland Revenue v. Church Commissioners for England* [1977] AC 329, per Lord Wilberforce at page 344(1); per Lord Morris of Borth-y-Gest at page 348(2), who said:

"If a receipt of money might be of an income nature or might be of a capital nature or might be partly the one and partly the other, then in the search for truth and reality all established facts should in my view be brought into survey"

- D and *Perrin v. Dickson*(3) [1930] 1 KB 107.)

- Although in the annuity agreement the £2,480 was referred to as the purchase price of the annuity, it was a term of the capital income plan in which the Respondent was engaging that the price paid for the annuity should be spent on the purchase of promissory notes of a value equal to the total of the annual payments to be made; and before the £2,480 had been credited to his account the Respondent had instructed his bankers, Slater Walker Ltd., to pay £2,500 to OCC for notes of that value. When a payment of £500 fell to be made to HOVAS, Slater Walker paid it, debiting his account with the amount and allowing his account to be overdrawn for a day or two for the purpose. Immediately on payment to HOVAS, Baldrene released notes to the value of £500 to HOVAS, presumably, though the Case Stated does not say so, on payment to them of £500 in part repayment of their loan to HOVAS, and HOVAS released the notes to Slater Walker. They were then met by OCC and the Respondent's account credited with £500. Throughout the whole operation the £2,480 and the notes of the value of £2,500 remained under the control of the Slater Walker group and HOVAS. It was never a sum of which the Respondent was free to dispose as he might wish. It was his duty as taxation manager of Slater Walker Ltd. to ensure the efficient working of the capital income plan. If anyone had sought to spend the sum received from HOVAS on anything other than the purchase of promissory notes from OCC, one wonders whether he would have been allowed to do so. It was at one time contended by the Crown that the payments made to HOVAS were in repayment of a loan by them to the Respondent. This contention was rejected, I think rightly. The £2,480 went with an additional £20 immediately on its being credited to his bank account to OCC. In *Perrin v. Dickson* [1929] 2 KB 85 Rowlatt J., whose judgment was affirmed on appeal, said(4): "The substance of the present transaction is that the appellant does not really adventure his capital at all. Under the terms of the policy the capital is in any event to be returned to him."

(1) 50 TC 516, at p 569.

(2) *Ibid*, at p 572.

(3) 14 TC 608.

(4) *Ibid*, at p 614.

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So here in my view the substance of the capital income plan did not involve HOVAS or any member of the Slater Walker group in adventuring their capital at all by the making of payments to individuals in return for five annual payments totalling the same amount. The £2,480 credited to the Respondent's account was part of the sum loaned by Baldrene to HOVAS. It had to be paid with an additional £20 to OCC and then on £500 being debited to the Respondent's account by Slater Walker Ltd., on presentation of promissory notes, OCC paid £500 into the Respondent's account with Slater Walker and were to continue to do so until the whole £2,500 had been repaid. In the circumstances I am unable to regard each payment of £500 as anything other than repayment by OCC of part of the £2,500 paid to that company, and to adapt Rowlatt J.'s sentence, one can say that under the terms of the capital income plan the capital sum provided initially by Baldrene and then by HOVAS was in any event to be returned to them.

The Special Commissioners thought that it was a fair description of the transactions to say that it was a bona fide commercial transaction without any element of bounty. That it had no element of bounty is clear. Attaching that label to it does not in my view exclude the operation of s 457. I would agree that that is a fair description if it is one that can properly be applied to a scheme operated by the Slater Walker group, no doubt as part of their business, solely designed to secure without their adventuring any capital the obtaining of tax advantages. In my view the payments of £500 emanating from OCC were payments of capital and the fact that one or two days before they were made, the sums were paid to HOVAS by overdrawing the Respondent's bank account was a mere matter of machinery which does not disguise the true character of the operation. If, contrary to my view, the sums of £500 were income in the hands of HOVAS, I see no reason to conclude that they were not payable out of profits or gains brought into charge.

For these reasons this appeal should in my opinion be allowed. It follows from what I have said that the Respondent was not entitled to deduct tax at the standard rate from the gross payments. His taxable profits or gains remain unaffected by the payments. If, on the other hand, the payments were income and not paid out of income which formed part of his profits or gains, they are by virtue of s 457 to be treated for the purposes of surtax as his income.

Lord Diplock—My Lords, I have had the advantage of reading in draft the speeches of my noble and learned friends, Lord Wilberforce and Viscount Dilhorne. Of the four grounds on which the Crown has sought the reversal of the judgment of the Court of Appeal I propose to examine only that one which Lord Wilberforce deals with last and Viscount Dilhorne first: the application of s 457 of the Income and Corporation Taxes Act 1970 to a transaction whose avowed and only purpose was the avoidance of surtax. It is common ground between my noble and learned friends that upon a literal interpretation of what, according to s 454, is to be understood as included in the expression "settlement", the transaction would fall within it. It is likewise common ground that Parliament must have intended some narrower construction than this to be placed on the word "settlement" in the context of s 457; for, unless it is, it is difficult to think of any transaction in consequence of it in which income paid by one person to another that would not fall within the section. The competing views are, on the one hand, that the context in which the word "settlement" appears in Part XVI of the Act shows a parliamentary intention to *exclude* from its meaning bona fide business transactions only and, on the other hand,

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- A that it shows an intention to *include* only transactions in which there is an element of bounty. My Lords, I do not find either of these limitations upon the meaning of the word easy to justify upon the language of the section itself or of Part XVI of the Act considered as a whole. In the section itself the draftsman has thought it necessary by subs (1)(a) and by subss (2)–(4) to exclude expressly from the operation of the section particular kinds of transactions in which there is clearly no element of bounty and which would also merit the description of bona fide business transactions. If one considers also the other sections in this Part of the Act in which the expressions “settlement” or “disposition” (to which a similar unrestricted meaning is assigned in s 434) appear there is nothing there that calls for a more restricted meaning to be given to either of those words than is ascribed to them by ss 454 and 434 respectively, since the nature of the particular transaction to which each of those other sections in Part XVI apply is limited by the description in the section of the legal effects of the transaction.

- So it seems to me that in order to reach a conclusion whether in addition to those transactions which are expressly excluded from s 457 by subss (1)–(4) any other kinds of transaction whereby income is paid by one person to another were intended to be excluded from its operation, it is necessary to apply to this Part of the Act a purposive construction and to ask oneself the question in relation to the particular kind of transaction which is under consideration. “Can Parliament really have intended to tax this particular kind of transaction by the wide words that the draftsman has used?” If the only sensible answer to that question is “No” the words of the Act should be understood as inapplicable to the transaction. That question when asked about a transaction which not only falls within the literal meaning of the words used in the section but has no other object than to enable the settlor to avoid a liability to surtax on his income which he would otherwise be obliged to pay, so far from inviting the answer: “No”, invites the answer: “Whatever kind of transaction Parliament may have intended to exclude it cannot have been this one.”

- F The earlier sections in Part XVI of the Act deal with the liability of the settlor to income tax as well as surtax on income payable to persons other than himself. Section 457 deals with his liability to surtax alone. As respects this element of tax, it is a sweeping-up section dealing, as subs (1)(e) makes clear, with surtax on income from settlements that do not comprise transactions of any of the particular kinds described in those earlier sections. That Parliament cannot have intended to sweep into its maw every transaction, even though entered into in the ordinary course of business, if it resulted in income being paid by one person to another, would seem self-evident; but as between giving to it purposive construction which involves excluding bona fide business transactions and one which involves excluding transactions in which there is no element of bounty, it does not seem to me to be correct to distinguish between these rival views by describing the former as involving judicial legislation and the latter as consisting of judicial construction only.

- For my part, in agreement with Viscount Dilhorne, I too, for the reasons that he gives, prefer the former; but even assuming that the latter be correct, it seems to me that upon the face of the document under which annual payments were made the transaction under consideration did involve an element of bounty. If one is to disregard the underlying realities of the whole tax avoidance scheme in which that document played an essential part and recognise only

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the legal obligations which it imposed upon the parties to it, Mr. Plummer A
 undertook an obligation to pay to HOVAS in return for a payment of £2,480,
 five sums of £851 each over a period of just over four years or a total sum of
 £4,255. This, as it seems to me, involves a substantial element of bounty. The
 fact that if he chooses to pay the sum out of his own profits or gains brought
 into tax, he can discharge his obligation in part by assuming (under s 52 of the B
 Act) the liability of the payee to pay income tax at the standard rate upon it
 and so, in the case of a charity such as HOVAS, transfer to the Revenue the
 ultimate burden of the element of bounty is a matter which the blinkers that
 the Court by *Commissioners of Inland Revenue v. Duke of Westminster*(1) [1936]
 AC 1 and cases that have followed it is enjoined to wear in revenue cases,
 compels it to ignore.

For these reasons I would allow this appeal. C

Lord Fraser of Tullybelton—My Lords, the details of the complicated tax
 avoidance scheme with which this appeal is concerned have already been
 described by my noble and learned friends Lord Wilberforce and Viscount
 Dilhorne, and I need not repeat what they have said. The questions that arise
 for decision are four:

1. Were the five annual payments made by the Respondent to HOVAS D
 payments of “an annuity or other annual payment charged with tax under Case
 III of Schedule D” within s 52(1) of the Income and Corporation Taxes Act
 1970?

2. Were they “payable wholly out of profits or gains brought into charge
 to income tax” within the meaning of that subsection?

3. Were the payments made otherwise than for valuable and sufficient E
 consideration in the sense of s 434 of that Act?

4. Were the payments income arising under a “settlement” within s 457
 and the definition in s 454(3), applied by s 459(1) of that Act?

1. On the first question the contention of the Crown was that the five sums
 of £500 each paid to HOVAS, notwithstanding that they were called payments
 of an annuity, were in reality of a capital nature. The name given to payments F
 by the parties to the transaction is of course not conclusive as to their true
 nature and in considering whether they are of an income or of a capital character
 the Court is entitled to have regard not only to the contractual documents, but
 to all the facts which are relevant for determination of the question—see
Commissioners of Inland Revenue v. Church Commissioners for England(2) [1977] G
 AC 329. In the Court of Appeal the Crown argued that the purchase price of
 £2,480 paid by HOVAS should be regarded as a loan and that the “annuity”
 payments were truly instalments of capital in repayment of the loan. This
 argument was rejected by Buckley L.J. on two grounds, with both of which I
 agree, and it was not repeated in your Lordships’ House. The argument for
 the Crown here was that they did not have to attach any particular label to the
 payments and that it was enough for them if they could show that the payments H
 were of a capital nature. It is of course true that purchase of an annuity always
 consists of paying out capital and receiving back in exchange money which, in
 a general sense, represents, at least in part, the capital purchase price. But it is
 accepted that in principle the whole annuity is income in the hands of the

(1) 19 TC 490. (2) 50 TC 516.

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- A recipient—see *Sothorn-Smith v. Clancy*⁽¹⁾ [1941] 1 KB 276—and I did not understand that Counsel for the Crown disputed that that was the general rule. It continues to be so notwithstanding the statutory provisions for taxation of purchased life annuities originating in the Finance Act 1956, s 27. The argument for the Crown sought to distinguish the present transaction from a normal purchase of an annuity in various respects so as to take it out of the general rule.
- B *Perrin v. Dixon*⁽²⁾ [1930] 1 KB 107 was cited as an example of a case which escaped the general rule partly because of the method of calculating the payments to be made in that case, and partly because of a term in the contract whereby in the event of the purpose for which the policy was effected failing either wholly or partly the assurance company was to repay to the respondent the whole or part as the case might be of the money paid by him. (In *Commissioners of Inland Revenue v. Church Commissioners*⁽³⁾ (*supra*) I was guilty of inaccuracy in referring to *Perrin* as a case where there had been a pre-existing relation of debtor and creditor between the parties.) The argument in the present case was that the obligation of the Respondent, like that of the company in *Perrin*, was simply to repay the money paid by the annuitant and that that money had never “ceased to exist” so as to satisfy the test stated by Watson B.
- D in *Foley v. Fletcher* (1858) 3 H & N 769, at page 784, thus :“An annuity means where an income is purchased with a sum of money, and the capital has gone and has ceased to exist, the principal having been converted into an annuity.”

- I cannot accept that contention. The transaction in the present case was exceptional in respect that the annuity payer was a private individual and not an established insurance company, and for that reason security for the payments was required. It was the provisions made for securing the payments that afforded the principal basis for the Crown’s argument on this part of the case. The argument was that the purchase price of £2,480 was never handed over to the Respondent so as to be under his control, but that it remained as a separate fund and was simply paid back to HOVAS by instalments. It is true that the Respondent never had unfettered control of the money. But that was only because it was earmarked from the beginning as security for his obligation to pay the annuity, and the investments which were acceptable as security were stipulated by HOVAS. The money belonged to the Respondent and with the agreement of HOVAS he could have changed the way in which it was invested. It was actually invested (along with a further £20 provided by the Respondent from his own resources) in promissory notes issued by Old Change Court (Investments) Ltd. That was in accordance with the suggestion in the scheme for the capital income plan. But it might have been invested in short-term gilt edged securities, as HOVAS explained in their letter of 11 March 1971 to the Respondent. Subsequently on 26 July 1971 the Respondent wrote to HOVAS asking them to accept British Transport stock 1968–73 in place of the promissory notes and HOVAS agreed to do so. For some unexplained reason, the change was not made. But the Respondent was the owner of the money and if it had been invested in a security which had either appreciated or depreciated in value, any profit or loss would have accrued to him.

- Apart from the limit imposed on the Respondent’s freedom to use the money, another unusual feature of the scheme was that HOVAS insured the life of the Respondent for annually reducing amounts to cover the possibility that he might die before he had paid all five sums of £500. This life assurance

(1) 24 TC 1. (2) 14 TC 608. (3) 50 TC 516.

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was not part of the contractual arrangement between HOVAS and the Respondent, though its existence is one of the facts which can properly be taken into consideration for the purpose of determining whether the annuity payments were truly of an income character. It was argued for the Crown that the life assurance was effected by HOVAS to safeguard its capital and that its existence showed that the capital was not being risked. In my opinion the fact that HOVAS chose to insure the Respondent's life is completely neutral for this purpose. The life policy would have provided the appropriate number of annual sums of £500 in the event of the Respondent dying before he had paid all the five sums that he had contracted to pay, but I cannot see that it throws any light on the question of whether these sums were income or capital in the hands of HOVAS. Once they were received by HOVAS it was free to use them in any way it thought fit. They were not instalments of the price of any property sold by HOVAS nor were they stamped in any other way as capital in its hands. In practice, of course, the £2,500 invested in promissory notes was the obvious source from which the annuity payments were to be made, but it was only a matter of convenience and if the Respondent had chosen to make all or any of the payments from some other source, he was free to do so. For example, if he had wished to save the small amount of interest on the overdraft which he incurred between the date of paying the annuity and receiving the proceeds of promissory notes repaid, he could have paid the annuity out of any other funds that he might have had available.

In these circumstances I am of the opinion that the payments of annuity were income in the hands of HOVAS and therefore answer the first question in the affirmative.

2. & 3. On these questions I have nothing to add to what my noble and learned friend Lord Wilberforce has already said.

4. The answer to this question turns upon the meaning to be given to the word "settlement" in s 457 of the Income and Corporation Taxes Act 1970. The meaning is defined in s 454(3) (applied by s 459) thus: "(3) . . . 'settlement' includes any disposition, trust, covenant, agreement or arrangement." The contract between the Respondent and HOVAS was not a settlement in the ordinary sense of that word, but it was an agreement and it is therefore within the extended meaning of settlement if the extended meaning is read literally. But if it were read literally it would include a large number of business agreements and would produce results so inconvenient and surprising as to lead to a strong presumption that they cannot have been intended. The courts have therefore recognised that some limit must be placed on the width of the words, and the need for some limit was accepted by both parties to this appeal. The limit must be fixed by some rule capable of general application. I do not think it is enough for the Court simply to decide the case on the view that Parliament could never have intended this transaction to escape taxation; a decision on that ground would approach too closely to arbitrariness.

The argument on this part of the appeal was about what was the proper rule to apply. The Crown contended that the definition in s 454(3) applied to all transactions that did not have a bona fide commercial reason, and that it applied to the present transaction, the sole reason for which was to avoid tax. The Respondent contended that the definition applied only to transactions which included an element of bounty. In many cases the two contentions might lead to the same result, but not in the present case. In my opinion the true rule

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- A is that the definition applies only where there is an element of bounty. One reason is that the commercial transaction test seems to go too far; many transactions which would be generally regarded as perfectly legitimate forms of investment are entered into solely, or at least predominantly, for tax reasons, and I think it would be wrong to suggest that they might be taxable for that reason alone. But the main reason in favour of the bounty test is that the word “settlement”, even allowing for its extended definition in s 454(3), seems to me to be used throughout Part XVI of the Act with a flavour of donation or bounty. I agree with the observations of my noble and learned friend Lord Wilberforce that the various provisions in Part XVI, to which he has referred, have a common characteristic of bounty. I would add that the same characteristic seems to apply to the first three exceptions to s 457(1) itself. Section 457(1) provides that:

“Where, during the life of the settlor, income arising under a settlement . . . is, under the settlement . . . , payable to . . . any person other than the settlor, then, unless . . . the income either—[here follow five exceptions] the income shall be treated for the purposes of surtax as the income of the settlor and not as the income of any other person.”

- D The first exception in para (a) is for (in effect) a pension to a former member of a partnership or his widow or dependants “being payments made under a liability incurred for full consideration”. Gratuitous payments to such persons are not excepted from the subsection. Secondly, by para (b) (which incorporates subs 2) there is a corresponding exception for (in effect) pensions paid by an individual who has acquired a business to a former owner or partner in the business or to the widow or dependants of such persons, and again the exception is limited by a provision “being payments made under a liability incurred for full consideration”. Thirdly, para (c) makes an exception for income arising under a settlement in favour of a former spouse of the settlor, or in favour of a spouse living apart from the settlor under a separation order of a court or under a separation agreement or when the separation is likely to be permanent. There is no express requirement in para (c) for full consideration, as that would clearly be inappropriate, but it is reasonable to assume that payments in the circumstances mentioned in this paragraph would usually be motivated by obligation, legal or moral, rather than by bounty. The other two exceptions in subs 457(1) are not relevant to this question, but the three to which I have referred seem to reinforce the argument that in the context of Part XVI the word “settlement” is used in the limited sense of settlements containing an element of bounty”.

- H This view of the Act receives some support from the speech of Lord Macmillan in *Chamberlain v. Commissioners of Inland Revenue*⁽¹⁾ [1943] 2 All ER 200, at page 204, in a passage which, as Lord Greene M.R. pointed out in *Hood Barrs v. Commissioners of Inland Revenue* 27 TC 385, draws attention to the importance of the statutory context. The bounty test was accepted without argument in *Commissioners of Inland Revenue v. Leiner* 41 TC 589. In *Bulmer v. Commissioners of Inland Revenue*⁽²⁾ [1967] 1 Ch 154, at page 166, it was applied by Pennycuik J., but he evidently thought that in the circumstances of that case there was no material difference between the bounty test and the commercial transaction test and did not have to decide between them.

- I I would dismiss the appeal.

(1) 25 TC 317, at p 331.

(2) 44 TC 1, at p 30.

Lord Keith of Kinkel—My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend Lord Wilberforce. My own views upon all the points argued in this appeal accord so closely with those which he has there expressed that no useful purpose would be served by my adding anything. I too would dismiss the appeal. A

Appeal dismissed, with costs.

[Solicitors:—Solicitor of Inland Revenue; Roney Vincent & Co.]

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