



# To Void the Avoidance: the Lessons of Recent Tax Case Law



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*“Every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.”<sup>1</sup>*

The above quote, albeit from a case almost 75 years old, remains a seminal statement. In this article we will try to help practitioners in understanding how the courts have grappled with the fact that tax-avoidance structures

remain a part of everyday commercial life. Given the limits of the article, we have not commented on the entire breadth of recent case law but have instead sought to confine ourselves to trying to see if lessons can be learned from certain pertinent tax cases. It is worth reminding ourselves that it will be the commercial substance of the transaction that will be taxed rather than its strict legal form, and, therefore, arrangements made and entered into with the

sole aim of recording a particular transaction or grouping of transactions in a particular way that attempts to categorise the event in a manner attracting less taxation are highly likely to be struck down by the courts or ruled as irrelevant to the actual commercial substance that should be taxed.

Taxation practitioners, lawyers and accountants will not be surprised to read that taxation

1. Lord Tomlin in the case of *IRC v Duke of Westminster* [1936] 19 TC 490.

evasion is a criminal offence and is entirely different and should not be confused with taxation avoidance, which is entirely legal. To prove the crime of taxation evasion, the prosecution must prove the facts beyond a reasonable doubt. This is a very high standard indeed. So-called unjust taxation avoidance is not a criminal offence, and, therefore, the standard of proof required is much lower. The standard required is on the balance of probabilities. People have the right to organise their affairs so as to pay only the minimum amount of taxation that the law requires instead of the legal maximum. It should be remembered, however, that in taxation law, as in all other areas of law, there are no absolute rights. We have come to a situation in the development of our taxation system where the difference between the two concepts is increasingly difficult to see clearly.

In addition, creative accounting, where attempts are made to account for the legal form of a transaction instead of the commercial substance, are in breach of the Financial Reporting Standards that the accountancy profession is obliged to comply with. This could be done to unfairly avoid paying a fair taxation. Such attempts, as well as being unethical, are highly likely to be struck down by our courts for unjust avoidance of a just and fair taxation. When the courts are hearing cases of this nature, a ruling must be made. A loss will fall somewhere when the ruling is made. It should not be assumed that, if a doubt exists, it will necessarily be used against the Revenue Commissioners.

### **The Courts Will Not Act as Tax Collectors but Instead Will Act as Interpreters of the Law**

The Irish courts have been anxious in determining recent cases not to be seen as usurping the authority of the Revenue Commissioners as the statutory entity charged with the collection of taxes on behalf of the State. The case of *Lorraine Kinsella v The Revenue*

*Commissioners*<sup>2</sup> is indicative of the fact that the Irish courts do not see themselves as having a role in tax collection and instead seek to confine themselves to matters of the interpretation of the Irish tax law. All financial statutory instruments must be interpreted by the courts on a literal basis. The so-called purposeful interpretation must never be applied to statutes of this nature.

It may be worthwhile to consider the case by way of background. The case involved Mr Shane Ryan, in the context of a disposal of a substantial shareholding he held in Ryanair Holdings plc. Following his marriage to the plaintiff in July 2002, a process commenced whereby the plaintiff sought to obtain the “badges” of Italian tax residency.

Ongoing accounting advice had been given to Mr Ryan and his wife in the course of 2002 and 2003 before the implementation of the transaction structure. The structure appears to have revolved around Mr Ryan remaining as an Irish resident but his wife seeking to obtain Italian tax residency, having leased an apartment and having registered on the register of the resident population (Anagrafe Della Popolazione Residente) in June 2003.

In 2003 it appears that Ms Kinsella spent more than 30 days but less than 91 days in Ireland (depending on a particular interpretation of the Ireland–Italy double taxation treaty). In addition, Mr Ryan and Ms Kinsella were to live together as husband and wife. The transaction structure involved the sale of the shares by Mr Ryan to Ms Kinsella and Mr Ryan contemporaneously provided a loan to Ms Kinsella that was secured on the shares as documented by way of a share sale agreement and a loan agreement. On 25 September 2003 Ms Kinsella purchased shares in Ryanair Holdings plc from her husband for a sum in excess of €18 million. As it was a transfer between spouses, no CGT arose under s1028 TCA 1997. In fact no monies changed hands, as the

monies were funded from the loan by Mr Ryan, which was secured on the shares.

Approximately two weeks later, Ms Kinsella sold her shares to a third party for an amount in excess of €19 million. She filed a tax return in Italy declaring a gain and giving rise to a tax liability in Italy of less than €40,000, thereby avoiding a large Irish CGT liability. The Italian tax was paid by her. When making her 2004 Irish tax return, Ms Kinsella’s tax advisers lodged an expression of doubt as regards their interpretation of the Ireland–Italy double taxation treaty, which, if correct, meant that only Italian tax was payable on the sale of the shares.

The case ultimately revolved around the interpretation of the Ireland–Italy double taxation treaty (which was signed way back in 1971) in respect of, firstly, whether the treaty covered CGT (which the court determined in favour of the applicants) and, secondly, a determination of the meaning of “day” as set forth in Article 3.1(e) of the double taxation treaty. This interpretation rested on whether the definition of “day” was determined under Irish or Italian tax law, as a day for the purposes of Italian tax law simply required the party to be present at any point in the relevant day while the Irish equivalent applied the “midnight test”, in that the person needed to be physically present in Ireland at midnight on the day in question. The relevant point here is that, if the Italian test was applied, the plaintiff was resident in Ireland for greater than 91 days in 2003 and consequently was not resident in Italy for the purposes of the Ireland–Italy double taxation treaty. However, if the midnight test applied, the plaintiff was not present in Ireland for greater than 91 days and consequently was a resident of Italy for tax purposes. The court determined in favour of the applicant in that “a day” should be determined in accordance with s819 of TCA 1997, hence the “midnight test” was applied.

2. [2007] IEHC 25.

Laffoy J in her judgment noted the strong criticism that was made of the plaintiffs and their tax-avoidance scheme during the trial, which she appeared to be quite neutral on. During the trial the counsel for the plaintiffs withdrew an aspect of the order sought by them that had sought that the court would restrain the defendant (the Revenue Commissioners) from assessing the plaintiffs for CGT. In addition, the judge was anxious to avoid making any judgment that may have affected the ability of the Revenue Commissioners to invoke the provisions of s811 TCA 1997 or raise a tax assessment on the plaintiffs, although Revenue's ability to raise an assessment was evidently jeopardised by the judgment. It was also evident from the judgments that the courts will not restrict the ability of the Revenue Commissioners to seek whatever recourse is available to them from a statutory perspective, and the judge was anxious to confine her judgment to the two issues of interpretation set out in the judgment.

There is an often obvious intrinsic link between the various statutes that cover Irish taxation law when they are applied to particular cases by taxation planning experts who attempt to arrange the facts to fit the law so that, when the Revenue Commissioners apply the law, there is an advantage to the client. The difficulty arises when these arrangements become artificial and an argument can be made that the strict legal form of the arrangement is far removed from the commercial substance of the transaction. It is in these cases that the Revenue Commissioners are most likely to seek the courts' interpretation, as they did in the case *supra*.

### Courts Will Exercise Greater Flexibility to Look at Non-domestic Taxation Structures

As mentioned above, it is evident that the courts will step in where they feel it appropriate in the context of a structure that they view as pure tax avoidance, and they are prepared to use the

additional avenues open to them when looking at non-domestic tax structures (VAT, for example). This is evidenced in the case of *Cussens & Others v Brosnan (Inspector of Taxes)*,<sup>3</sup> which was a High Court appeal of a decision at the Circuit Court by Kenny J. By way of background, Mr Cussens and his partners were the owners and developers of a site of holiday homes in Baltimore, Co. Cork. Before the sale of the homes (and, as the judgment stated, solely for the purposes of tax avoidance) the partners entered into a 20-year-and-one-month lease with a connected company in respect of the development. This connected company immediately leased the development back to the partners, and the lease and leaseback were then mutually surrendered. The partners accounted for the VAT on the capitalised value of the lease and were thereby entitled to dispose of their freehold interest to another third party without paying VAT in the ultimate sale of the holiday homes. The Circuit Court viewed the lease and leaseback arrangement as an abusive practice that should be disregarded for the purposes of the VAT assessment.

The perceived lack of commercial reality to the structure was exacerbated by the fact that the legal interest in the land on which the holiday homes were built was held by a financial institution, and the mortgage deed in question contained a negative pledge clause that expressly barred the partners from entering into lease transactions without the written consent of the mortgagee. The partners did not obtain such consent before entering into the lease and leaseback arrangement.

In the Circuit Court, Kenny J found that the leasing transactions constituted an abuse of practice in accordance with European law and, accordingly, the lease and leaseback arrangements were to be disregarded for the purposes of a VAT assessment. Perhaps it could be said that the judge took a purposeful view of the facts and decided the matter holding the

commercial substance in mind, along, of course, with a literal interpretation of the laws.

Based on the Circuit Court findings, the partners sought to determine a point of law in the High Court regarding whether the doctrine of "abuse of practice" in European law was applicable. In addition, the partners further contended that the principle of "abuse of practice" had no application in the absence of a legal instrument transferring the principle from European into Irish law.

Charleton J, in refusing the appeal, made an expansive judgment that was expressed with remarkable clarity. It was clear that the artificiality of the transaction was at the forefront of his mind when delivering his judgment. Below, it will be seen that, had a strict literal interpretation of the arrangements been made and the commercial substance assessed as a secondary concern, the result would have been very different.

By way of background, the fact that the concept of an abuse of practice can identify and then nullify a purported compliance of law has been part of the European Court of Justice since the *van Binsbergen*<sup>4</sup> case. It has now become a principle of general application in all areas of European law, including taxation. When discussing the *Cussens* case, it is important to remember that income tax, for example, is entirely based on Irish legislation and therefore would not have been left open to the judicial interpretation applied in the *Cussens* case. Charleton J went on to say that the court's interpretation of domestic tax legislation does not apply any general principle whereby what might be called unworthy transactions that have no apparent benefit other than being a tax-avoidance mechanism are analysed in terms of the substance of the transaction.

In this regard, Charleton J referred to the decision of Carroll J, where Carroll J had disagreed

3. [2008] TIR 129.

4. *van Binsbergen v Bestuur van de Bedrijfsvereniging voor de Metaalnijverheid C-33/74*; [1974] ECR 1229.

5. *McGrath v McDermott (Inspector of Taxes)* [1988] IR 258.

specifically with the English case of *Furniss v Dawson* in her judgment in the *McGrath v McDermott*<sup>5</sup> case, where she stated that the correct approach to interpreting taxation legislation in the Irish jurisdiction was to adopt a literal approach and that tax avoidance was an issue to be dealt with separately by the legislature through detailed statutory provisions enacted year after year once gaps were identified through which tax was seeping away by tax avoidance and by filling the gaps by specific legislation. One sentence, in particular, stands out in Carroll J's judgment in the *McGrath v McDermott* case:

*"If the legislature...has failed to 'plug a hole' in advance or has failed to pass a law which strikes generally at tax avoidance schemes... it is not for the courts to intervene."*

The Supreme Court upheld this approach, although Finlay CJ in its judgment in the *McGrath v McDermott* case specifically noted that he felt that the complex structure in the case was not a sham and that the shares in the transaction that had constituted the tax-avoidance measure had been genuinely sold and purchased. He held in his judgment that the courts do not possess the power to add to or delete from express statutory provisions in order to achieve a fair or desirable result, as it would be an invasion by the court into the powers expressly reserved to the legislature. The general anti-avoidance measure contained in s811 TCA 1997 generally came out as a consequence of these decisions, but they are worthwhile noting, nonetheless. It is clear that the judiciary is mindful of the doctrine of division of powers between itself and the Oireachtas. It has continually expressed its view that it is for the Oireachtas to pass legislation, which, when interpreted literally by the courts, will provide the Revenue Commissioners with their desired result.

In his judgment in the *Cussens* case, Charleton J stated that the lease and leaseback had no commercial reality and, therefore, constituted an abuse of practice within the doctrines identified by the ECJ and that the lease and leaseback should be redefined for the purposes of VAT in order to reflect the true reality of the actions of the partnership.

He stated that the ECJ decisions of abuse of practice are of general application and they require national courts to redefine abusive measures in the courts as a reality.

### Courts May Use Corporate Law to Undermine Structure

The judgment of Laffoy J in the *Fyffes/DCC*<sup>6</sup> High Court case, which was subsequently appealed successfully by Fyffes (which appeal left this element of her judgment untouched), is also revealing as regards the court's ability and desire to look at corporate structures. By way of background, Fyffes's assertion was that a profit that accrued to Lotus Green was, in reality, a profit which accrued to DCC. In order to succeed in that argument, Fyffes required the High Court to agree that Lotus Green and DCC were a single corporate entity for the purposes of the relevant legislation.

Laffoy J lent some reliance to the judgment in *Power Supermarkets Limited v Crumlin Investments*,<sup>7</sup> where Costello J stated in an equivalent scenario:

*"It seems to me to be well established from these as well as other authorities...the Court may, if the justice so requires, treat two or more related companies as a single entity."*

There is a concern apparently evident from Laffoy J's judgment that the concept of the justice of the case is elusive for a third party who is examining the transaction from the outside to ascertain whether it applies. An example of

this is the wording of Carroll J in the case of *State (Thomas McLnerney & Co. Ltd) v Dublin County Council*,<sup>8</sup> where he stated:

*"In my opinion the corporate veil is not a device to be raised and lowered at the option of the parent company or group. The arm which lifts the corporate veil must always be that of the justice. If justice requires...the courts should not be slow to treat a group of subsidiary companies and their parent company as one."*

Having examined the law in the area, Laffoy J determined that Lotus Green should be regarded as having acted as the agent of DCC in relation to the shareholding in Fyffes, as to do otherwise would (according to Laffoy J) lead to an injustice in that it would allow DCC to evade its obligations under s109 of the Companies Act 1990 (since repealed). Although not strictly a tax case, the High Court decision in this case is revealing of the courts' attitude to structures and how they are prepared to look through them as the case dictates. The justice of this case turned on its particular facts, but much can be gleaned from it regarding how the judiciary will view these matters in the future.

### Courts Will Look at Commercial Substance of Transaction

This point also arises in all of the other cases mentioned above, but it is worthwhile to consider the High Court judgment given by Smyth J in the *O'Flynn Construction*<sup>9</sup> case. We are sure that the context of the case has been well discussed in prior editions; however, in broad terms, it arose from the use by the O'Flynn Group of excess export sales relief reserves of Mitchelstown Export Company Ltd, a member of the Dairygold group of companies. This resulted in the ability of the O'Flynn Group to avoid a liability to advance corporation tax and also avoided income tax for two individuals on dividends paid

6. *Fyffes plc v DCC plc, S&L Investments Ltd, James Flavin and Lotus Green Ltd* (unreported, HC, 21 December 2005).

7. (Unreported, HC, 22 June 1981).

8. [1985] 1 ILRM 513.

9. (Unreported, HC, 2005/403R).

by *O'Flynn Construction*. A number of steps were designed and carried out so that these reserves were sold by Mitchelstown Export Company Ltd to an unconnected non-export sales relief company, being O'Flynn Construction, for cash consideration.

The court mentioned that s811 TCA 1997 (previously s86 FA 1989) contained specific anti-avoidance measures that were clearly intended to block particular schemes considered unacceptable by the legislature. The court further stated that the general anti-avoidance provisions are intended to counteract artificial schemes, being transactions of little or no commercial reality that are carried out primarily to create an artificial tax deduction or to avoid or reduce a tax charge. Such schemes and arrangements can be considered to be unjust avoidance measures of a just taxation.

The High Court felt, in its judgment of the *O'Flynn* case, that the judgment of Carroll J in the High Court case of *McGrath v McDermott* and Finlay CJ's statements in the Supreme Court appeal of that case set out the basis on which the courts implemented s86 (now s811).

It is worthwhile at this point to consider the position in the Supreme Court of Canada, which has arguably a more advanced tax-avoidance system than the English and Irish jurisdictions, and in particular the case of *Canada Trustco Mortgage Company v Canada*,<sup>10</sup> where the court mentioned at one stage that:

*“Abuse of tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationship contemplated by the provisions.”*

These words appear to have been of great relevance to the High Court decision in the *O'Flynn* case, as the court felt that the transaction that was subject matter of the decisions whereby export sales relief reserves in the Dairygold Group were transferred to a company that was not engaged in the manufacture of goods for export was completely at odds with the purpose for which the exports sales relief legislation was provided. The way in which the High Court used the line of thinking from the Canadian court decision allowed it to interpret the facts, which revealed that the true purpose of the arrangement was to avoid taxation. A further literal interpretation of the law then allowed a taxation liability to be raised.

### Courts Will Not Generally Come to the Aid of Defectively Drafted Transaction Documents

There is no substitute for a well-drafted agreement, as the courts will not generally correct documentary weaknesses or lapses. The very recent English case of *Chartbrook Limited v Persimmon Homes Limited and Others*<sup>11</sup> is worth a review in this regard.

In this case, the House of Lords had to consider whether to admit pre-contractual paperwork as evidence of a claim where it was contended that something had gone wrong in the drafting of a contract.

In the *Chartbrook* case a dispute arose in respect of a debt arising from a land development agreement between the owner, Chartbrook, and the developer, Persimmon. The case revolved around the price provisions of the agreement and, in particular, an element of the price referred to as the “additional residential payment” (ARP), which was expressly defined in the agreement by reference to a mathematical formula and the drafting of which had changed on an ongoing basis throughout the drafting process. The parties differed in

their interpretation of the construction of this formula. Persimmon sought to admit evidence of the parties' pre-contract negotiations in demonstrating that its construction of the formula was the correct one.

Both the High Court and the Court of Appeal, in rejecting Persimmon's claim, found that this was not a case where the so called “exclusionary rule” should be displaced (i.e. pre-contract negotiations/drafts should be excluded from consideration when interpreting contractual provisions).

Persimmon appealed the case to the House of Lords. The House of Lords confirmed that there was no clearly established case for departing from the exclusionary rule. The House of Lords, however, disagreed with the lower courts, deciding that to interpret the definition of ARP literally made no sense. The House of Lords felt that all that is required is that it should be evident that something has gone wrong with the language and that it should be clear what a reasonable person would have understood the parties to have meant.

While this decision may provide some comfort to contracting parties that the courts may be prepared to intervene and take patent mistakes into account in construing a contractual term, the circumstances in which they will do so are very limited, despite the fact that each party has the right to adduce relevant and admissible evidence to prove that certain terms were included in an oral contract.

### Courts Will Not Fill in Any Statutory Lacuna

A case involving Glenkerrin Homes<sup>12</sup> centred on the old s40(2) of the Stamp Duties Consolidation Act 1999, which provided:

*“Where the consideration, or any part of the consideration, for a conveyance on sale consists of any security not being a*

10. [2005] SCC 54.

11. [2009] UKHL 38.

12. *The Revenue Commissioners v Glenkerrin Homes Ltd* [2007] TITR 119.

marketable security, the conveyance is to be charged with ad valorem duty **in respect of the amount due** on the day of the date of the conveyance for principal and interest on that security” [emphasis added].

The facts surrounding the case very briefly were as follows:

- › Glenkerrin Homes Limited agreed to purchase certain land. The deposit provided for in the contract was paid.
- › The conveyance was completed, but the balance purchase monies were not paid over, and instead the vendor facilitated a completion whereby Glenkerrin provided:
  - » an undertaking to pay the balance monies on a specified date (the undertaking included a declaration that the balance was not due or payable before the specified date) and
  - » an unconditional bank guarantee in favour of the vendor as security for the balance.
- › In exchange for the receipt of the above-mentioned documents, the vendor provided an executed transfer of the land.
- › When the deed was presented to the Revenue Commissioners, they purported to assess stamp duty on the entire consideration (to include the balance due).
- › This was appealed by Glenkerrin, and the Appeal Commissioners concluded in favour of Glenkerrin that the security provided for the balance of the purchase price was a non-marketable security and that there was no “amount due” on the security on the date of the deed of transfer.

The Revenue Commissioners sought a case stated to the High Court on the construction of the phrase “amount due”.

Laffoy J found in favour of the Revenue Commissioners, which she did on a literal reading of the relevant section of SDCA 1999. Laffoy J stated that the Appeal Commissioner had mistakenly construed the word “due” as being synonymous with payable, and she went on to say:

*“In my view, he took a mistaken view of the law in so doing. He failed to properly take account of the context in which the legislature deployed the word ‘due’, in ascertaining what it intended by the use of that word. The legislature was identifying the sum on which stamp duty would be charged where, instead of money, all or part of the consideration consisted of a non-marketable security and it expressly equated that sum with the amount due on such security on the material date.”*

How the courts read tax legislation is obviously of importance to all practitioners, and Laffoy J concurred in her judgment with a line of judicial reasoning where she noted that the principle in the *Cape Brandy Syndicate*<sup>13</sup> case applied, which principle was stated along the following lines:

*“It is urged that in a taxing Act, clear words are necessary to tax a subject...It simply means that in a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language itself.”*

Laffoy J, in allowing the appeal of the Revenue Commissioners, held that, as a matter of commercial and common sense, the phrase “amount due” in s40(2) includes all sums, whether principal or interest, in respect of which there was a legal liability on the material date, including such sums payable in the future.

Section 40(2) of SDCA 1999 has been since amended by s116(1) FA 2005 and now provides as follows:

*“Where the consideration, or any part of the consideration, for a conveyance on sale of any property, consists of any security not being a marketable security, the conveyance shall be charged with ad valorem duty as a conveyance on sale of that property for a consideration equal to the value of that property on the date of the execution of the conveyance”.*

It is interesting to note that Laffoy J appears to have paid little regard to the fact that the legislature had sought to fill in the legislative lacuna in s40 as a result of the *Glenkerrin* case, and in doing this she relied on Griffin J’s statement in the *Cronin v Cork County Property*<sup>14</sup> case, in which he said that the courts cannot construe a statute in light of amendments that may thereafter have been made to it.

### Possible Technical Compliance May Not Be Enough

The recent case of *Patrick W Keane & Co. v the Revenue Commissioners*,<sup>15</sup> which related to s80 SDCA 1999, is interesting to note. By way of reminder, s80 provides that, *inter alia*, subject to the satisfaction of certain conditions, stamp duty shall not be chargeable in the case of a bona fide reconstruction of any company or companies or the amalgamation of any companies. The structure of the Keane transaction in principle appears to be that the assets of the business were split into “A” assets, “B” assets and “C” assets. In addition, a new class of “E” shares was created. The “E” shares, which were non-voting and had no distribution rights, were issued to all of the five existing shareholders. The ordinary share capital was also divided into “A”, “B” and “C”. The “A” and “B” assets were transferred to two new companies (owned separately by certain of the shareholders of the existing company), and the “C” assets were retained by the existing company. Both of the new companies issued “E” shares to the holders of the “E” shares in the existing company.

13. *Cape Brandy Syndicate v Commission of Inland Revenue* [1921] 1 KB 64.

14. *Cronin (Inspector of Taxes) v Cork County Property Ltd* [1980] IR 559.

15. [2008] TITR 57.

Patrick W Keane & Co. Ltd (“the Company”), a jewellery business based in Cork, sought Revenue approval for relief from stamp duty in respect of the transaction. In addition, the Company sought and obtained High Court approval, under s203 of the Companies Act 1963, for the scheme of arrangement and reconstruction. Revenue refused the Company’s claim for relief on the basis that the reorganisation was not effected in pursuance of a bona fide scheme of reconstruction. Ultimately, the case ended up in the High Court to decide whether the transaction constituted a reconstruction within the meaning of s80 SDCA 1999.

Revenue argued that what occurred was a division/partition of the Company’s businesses between the shareholders. The court appears to have taken regard of the fact that it viewed the creation of the “E” shares as a means of “guaranteeing” technical compliance with the relief, and the court stated that compliance was not merely technical and that the quality of ownership must be real and meaningful.

It was held that the arrangement did not constitute a reconstruction or amalgamation. While the words “reconstruction” or “amalgamation” are not defined in s80 SDCA 1999, the court felt that they must be construed in a manner that is consistent with the objective of the statutory provision, which is to grant relief against a stamp duty charge where the underlying ownership of the undertaking transferred remains substantially unaltered.

Edwards J felt that the transaction was a partition dressed up as a reconstruction. In considering this judgment, one needs to bear in mind that s80 by its terms has a bona fide test built into it, which sets the bar a little higher for taxpayers.

### What Makes a Structure a “Sham”?

A “sham” is a phrase one comes across regularly in practice, but in reality it is another way of describing a fraud, as the documents and the

acts done appear to create legal rights and obligations different from the actual legal rights and obligations that the parties intended to create. In essence, the documents created are a fiction. This is very different from when the courts look at a genuine transaction and re-characterise it differently, as in, for example, the *Keane* case described immediately above. The case of *Hitch v Stone (Inspector of Taxes)*<sup>16</sup> is helpful for establishing how the courts form a view on a “sham”:

- › The courts may examine external evidence (i.e. they can look outside the transaction documents).
- › The parties must have intended to create different relations, rights or obligations from those set out in the documents.
- › The fact that the document may appear to be non-commercial or even artificial does not make it a “sham”.
- › A later departure by the parties from the provisions of the document does not automatically mean that it is or was a “sham”.
- › The intention must be a common intention.

### What Lessons Can Be Learned for Practitioners in Putting Together Structures?

- › Every taxpayer has a right to structure its affairs in such a way as to minimise its tax liability.
- › Every step of the structure should support the entire structure, and this includes any preparatory steps.
- › Tax law is unique and distinct from other areas of law – note that the structure in the *Keane* case had previously been approved for the purposes of s203 of the Companies Act 1963.
- › There must be a commercial reality to the underlying transaction, as the courts

reserve the authority to re-characterise the transaction.

- › The courts have a policy of reading tax legislation fairly and literally.
- › Be careful to avoid spurious justifications for the structure.
- › Any non-domestic tax structures need to consider EU law.
- › Clear and precise drafting is absolutely imperative – the courts will not generally offer any comfort to correct imperfect drafting, and any documentary lapses may have severely negative effects. See the English case of *Spectros International plc v Madden (Inspector of Taxes)*,<sup>17</sup> which was a tax planning structure that required the taxpayer to be able to say that the purchase price was \$3m, not \$23m, as the Inland Revenue alleged. Unfortunately for the taxpayer, the share purchase agreement and two other supporting documents clearly stated the purchase price to be \$23m.
- › Following on from the point above, professional advisers (whether tax, legal or accounting) need to stay in communication continually in order to seek to prevent any documentary or structural lapses occurring.

In the future, taxation practitioners are likely to rediscover some useful principles of law, in particular in the area of the law of evidence. The principles outlined above will be useful to those charged with examining in detail some of the arrangements entered into over the past decade, during which there was an increase in the number of avoidance measures entered into.

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16. [2001] STC 214.

17. [1997] STC 114.