HIGH COURT OF JUSTICE (CHANCERY DIVISION)—25TH, 26TH AND 27TH MARCH 1968 A

COURT OF APPEAL—21ST AND 22ND APRIL AND 14TH MAY 1969

HOUSE OF LORDS—21ST, 22ND, 23RD AND 24TH JUNE AND 21ST OCTOBER 1971 B

Lupton (H.M. Inspector of Taxes) *v.* F.A. & A.B. Ltd.([1])

Income tax, Schedule D—Loss in trade—Dealer in securities—Dividend-stripping—Whether shares bought for dividend-stripping held as stock-in-trade.

In the years 1959–60 *to* 1961–62 *the Respondent Company traded as a dealer in stocks and shares. In addition to numerous other transactions in stocks and shares it carried out five dividend-stripping transactions, partly forwards and partly backwards, all with the object of making money bearing in mind the fiscal advantages which were expected to follow.* C

Four of these transactions involved the creation for purchase by the Company of shares with special rights. In one typical transaction, entered into in December 1959, *such shares were bought for* £625,000 *down with a warranty that a dividend of* £125,000 *net would be paid immediately and further dividends amounting to* £500,000 *net by December* 1964, *and a stakeholder was appointed to hold* £500,000 *deposited by the Company and release it to the vendors as and when the dividends were paid. The legal costs and stamp duty borne by the Company amounted to* £3,572, *and it sold the shares for* £455,000 *after dividends of* £170,000 *net had been received.* D E

In the remaining case the Company on 30*th March* 1960 *bought for some* £1,700,000 *the issued share capital of an investment company with a trading sub-subsidiary. The vendor undertook that the revenue profits of the investment company's immediate subsidiary were then sufficient to declare a dividend of* £800,000 *net and that the Respondent Company would be entitled to recover from the Inland Revenue the tax deducted from any dividends paid to it by the investment company out of that dividend; they further undertook if the Company failed to recover any such tax to pay the difference between half the tax recovered and* £200,000, *and the Company undertook to proceed with a repayment claim with due diligence. The vendors deposited* £200,000 *with a stakeholder as security for their undertakings, to hold for three years on trust to release to the vendors that sum or half the tax recovered by the Company. The Company did not sell the shares after payment of the relevant dividend, but on a revaluation of the investment company's assets the transaction showed a loss of* £182,980 *after taking account of the net dividends received but not of the claim to repayment of tax or compensation in lieu.* F G

On appeal against the refusal of claims to relief under s. 341, *Income Tax Act* 1952, *for the years* 1959–60 *to* 1961–62 *in respect of trading losses resulting from falls in the value of the shares purchased in the five transactions, whether attributable to the payment of dividends or otherwise, it was contended for the Crown that the transactions were not entered into by the Company in the course of trade and the shares were never part of its stock-in-trade. In a decision given shortly after the decision of the Court of Appeal in* Finsbury Securities Ltd. *v.* Bishop 43 T.C. 491 H

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([1]) Reported (Ch.D.) [1968] 1 W.L.R. 1401; [1968] 2 All E.R. 1042; (C.A.) [1969] 1 W.L.R. 1627; 113 S.J. 855; [1969] 3 All E.R. 1034; (H.L.) [1972] A.C. 634; [1971] 3 W.L.R. 670; 115 S.J. 849; [1971] 3 All E.R. 948.

A *the Special Commissioners held, following that decision and* J. P. Harrison (Watford) Ltd. *v.* Griffiths 40 T.C. 281, *that the transactions formed part of the Company's trade.*

Held, *that all the transactions were tax devices and not trading transactions.*

Finsbury Securities Ltd. *v.* Bishop 43 T.C. 591 (H.L.); [1966] 1 W.L.R. 1402 *applied;* J. P. Harrison (Watford) Ltd *v.* Griffiths 40 T.C. 281; [1963] A.C.1
B *distinguished.*

CASE

Stated under the Income Tax Management Act 1964, s. 12(5) and the Income Tax Act 1952, s. 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

C 1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 15th, 16th and 19th July 1965, F. A. & A. B. Ltd. appealed against an assessment to income tax in the sum of £1,000 made upon the Company for the year 1960–61 and claimed relief from tax under s. 341 of the Income Tax Act 1952 for the years 1959–60, 1960–61, and 1961–62 in respect of losses claimed by the Company to have been sustained by it in those years in its
D trade as a dealer in stocks and shares.

2. Shortly stated, the questions for our decision which are still in issue between the parties were:

(1) whether or not shares which F. A. & A. B. Ltd. acquired in five other companies were acquired by F. A. & A. B. Ltd. in the course of its trade as a dealer in stocks and shares and accordingly formed part of its stock-in-trade;
E and

(2) whether or not a sum of £13,325 formed part of the cost to F. A. & A. B. Ltd. of shares which it acquired in one of the said five companies.

3. The following witnesses gave evidence before us:

(1) Mr. Clifford Henry Barclay F.C.A. (hereinafter referred to as " Mr. Barclay "), a director of Barro Equities Ltd., the parent company of a group of
F companies of which F. A. & A. B. Ltd. is a member (hereinafter referred to as the " Barro Equities group "). Mr. Barclay recently became a director of F. A. & A. B. Ltd. and is also a director of certain other companies in the Barro Equities group.

(2) Mr. Anthony Holloway F.C.I.S., A.C.C.A., who in December 1959 joined F. A. & A. B. Ltd. as its accountant and assistant secretary and became a
G director of that Company from October 1960 to September 1961.

(3) Mr. Edward Lawson F.C.A., a principal accountant employed in the Secretaries' Office of the Board of Inland Revenue.

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

(1) Memorandum and articles of association of F. A. & A. B. Ltd.

(2) Balance sheets and profit and loss accounts of F. A. & A. B. Ltd. for the
H four years ended 31st March 1959 to 31st March 1962 inclusive, together with directors' reports relating to the Company's accounts for the last three of those years.

(3) Particulars of dividends received by F. A. & A. B. Ltd. for the years ended 31st March 1960 and 31st March 1961.

(4) Abstract of accounts of F. A. & A. B. Ltd. for the years ended 31st March 1960, 31st March 1961 and 31st March 1962. A

(5) Investment schedules of F. A. & A. B. Ltd. and summaries of the Company's profit and loss accounts for the years ended 31st March 1955 to 31st March 1959 inclusive, together with copies of (*a*) entries in the Company's investment control account from 1st April 1959 to 29th March 1962, and (*b*) entries in the Company's profits or loss on sale of shares account from 14th August 1959 to 31st March 1962. B

(6) Documents relating to the acquisition by F. A. & A. B. Ltd. of shares in the following five companies, namely Sotheby & Co. (an unlimited company), Leggett Nicholson & Partners Ltd., Western Productions Ltd., Oakroyd Investments Ltd. and Balcombe Productions Ltd. (hereinafter referred to as "S. & Co.", "L.N.P. Ltd.", "W.P. Ltd.", "O.I. Ltd." and "B.P. Ltd." respectively) as follows: C

(*a*) Documents relating to the acquisition of S. & Co. shares:

(i) Resolutions passed on 21st December 1959.

(ii) Letter from Hambros Bank Ltd. to F. A. & A. B. Ltd. dated 22nd December 1959.

(iii) Sale agreement dated 22nd December 1959. D

(iv) Stakeholder agreement dated 22nd December 1959.

(v) Bundle containing copies of minutes commencing with extract from minutes of board meeting of Adjant Ltd. held on 21st December 1959, together with certain correspondence.

(*b*) Documents relating to the acquisition of L. N. P. Ltd. shares:

(i) Sale agreement dated 23rd March 1959, together with copy of resolution passed on 23rd March 1959. E

(ii) Agreement dated 31st March 1959.

(iii) Deed dated 31st March 1959.

(iv) Deed dated 18th August 1961.

(v) Copy of minutes of meeting of directors of F. A. & A. B. Ltd. held on 31st March 1959. F

(*c*) Documents relating to the acquisition of W. P. Ltd. shares:

(i) Sale agreement dated 18th September 1959.

(ii) Stakeholder agreement dated 18th September 1959.

(iii) Bundle containing copy of minutes of meeting of directors of F. A. & A. B. Ltd. held on 18th September 1959, together with certain correspondence.

(*d*) Documents relating to the acquisition of O. I. Ltd. shares: G

(i) Sale agreement dated 30th March 1960.

(ii) Stakeholder agreement dated 30th March 1960.

(iii) Bundle containing copies of minutes commencing with minutes of a meeting of directors of F. A. & A. B. Ltd. held on 29th March 1960.

(iv) Letter from Messrs. Cooper Bros. & Co., chartered accountants, to Barro Equities Ltd. dated 14th July 1961. H

(*e*) Documents relating to the acquisition of B. P. Ltd. shares:

(i) Sale agreement dated 1st April 1960.

(ii) Stakeholder agreement dated 1st April 1960.

(iii) Copy of minutes of meeting of directors of F. A. & A. B. Ltd. held on 31st March 1960.

A (7) Statements summarising transactions by F. A. & A. B. Ltd. in shares in S. & Co., L. N. P. Ltd., W. P. Ltd., O. I. Ltd. and B. P. Ltd.

(8) Copy of letter from Messrs. Chipchase, Wood & Jacobs, chartered accountants, to H.M. Inspector of Taxes, Brook District, dated 27th January 1961, and of certain enclosures thereto.

Copies of the documents referred to in subheads (4), (6) and (7) above are B attached hereto as exhibits (marked " A " " B(*a*)(i) " to " B(*e*)(iii) " and " C " respectively) and form part of this Case[1]. The other above-mentioned documents are not attached to, and do not form part of, this Case, but copies are available for inspection by the Court if required.

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

C (1) The Respondent Company, F. A. & A. B. Ltd., was incorporated on 10th May 1952, and had at all material times an issued share capital of £1,000 consisting of 1,000 ordinary shares of £1 each.

(2) During the years which were the subject of the appeal and claim before us, namely the years 1959–60, 1960–61 and 1961–62, the Company had entered into numerous transactions in stocks and shares other than the five transactions D hereinafter referred to, and it was during those years admittedly trading as a dealer in stocks and shares.

(3) During the years 1959 and 1960 the Company acquired certain holdings of shares in S. & Co., L. N. P. Ltd., W. P. Ltd., O. I. Ltd. and B. P. Ltd. The transactions entered into by it in shares of each of these companies were dividend-stripping transactions.

E (4) The transactions which were entered into by F. A. & A. B. Ltd. in relation to shares of these five companies may be summarised as follows:

(*a*) *S. & Co. transaction.*

This transaction involved forward dividend-stripping, and in so far as the profits of S. & Co. for the calendar year 1959 had largely been earned at the date of the transaction there was also an element of backward stripping involved.

F On 21st December 1959 a resolution was passed at an extraordinary general meeting of S. & Co. that the capital of that company be increased from £200,000 to £202,000 by the creation of 2,000 preferred ordinary shares of £1 each having the rights specified in a further resolution passed at the same meeting but no other rights as to voting or otherwise. Subject to the payment of dividends payable on the preference shares of S. & Co., the rights conferred G on these preferred ordinary shares included, with certain qualifications, the right during a period of five years from the date of issue to all dividends declared out of the profits of the company (other than any profits on capital account) earned subsequent to their issue and thereafter to a fixed non-cumulative preferential dividend at the rate of 8 per cent. per annum. The preferred ordinary shares were allotted credited as fully paid to and amongst holders of H the company's ordinary shares. The resolutions hereinbefore referred to are set out in exhibit B(*a*)(i) annexed[1].

On 22nd December 1959 F. A. & A. B. Ltd. entered into an agreement (exhibit B(*a*)(iii) annexed[1]) with certain ordinary shareholders of S. & Co. (therein and hereinafter referred to as " the shareholders ") whereby it agreed to purchase from them the 2,000 preferred ordinary shares of S. & Co. for the sum I of £625,000, payable on completion of the sale and purchase the same day.

[1] Not included in the present print.

By clause 4 of this agreement the shareholders jointly and severally undertook and warranted to the purchaser, *inter alia*, (i) that an interim dividend of £125,000 net of tax would be declared in respect of the current accounting period ending 31st December 1959 and would be paid to the holders of the purchased shares within seven days of completion, and (ii) that the aggregate of all dividends paid by the company on the purchased shares prior to 22nd December 1964 (exclusive of the said interim dividend) would amount to £500,000 net of tax.

On the same day F. A. & A. B. Ltd., the shareholders and Northern Holdings Ltd. (a company associated with Hambros Bank Ltd.) entered into an agreement (exhibit B(*a*)(iv) annexed[1]) which provided, *inter alia*, that Northern Holdings Ltd. (therein referred to as " the Stakeholder ") would hold the sum of £500,000 as security for the undertaking and warranty for the benefit of F. A. & A. B. Ltd. contained in the above-mentioned sale agreement. Under the agreement the said £500,000 was to be released to the shareholders in amounts equal to dividends net of tax declared and paid on the preferred ordinary shares in excess of the interim dividend of £125,000 net of tax as and when such dividends were declared and paid.

By a letter also dated the same day (exhibit B(*a*)(ii)[1]) Hambros Bank Ltd. undertook to extend, if necessary, sufficient facilities to Northern Holdings Ltd. to enable them to carry out their obligations under the above-mentioned stakeholder agreement.

In accordance with resolutions passed by F. A. & A. B. Ltd. and Adjant Ltd. (exhibit B(*a*)(v)[1]) the latter company acted as nominee of F. A. & A. B. Ltd. in relation to the transaction in S. & Co. shares.

During the year ended 31st March 1960 Adjant Ltd. received on behalf of F.A. & A.B. Ltd. the said interim dividend of £125,000 net of tax, together with two other dividends totalling £45,000 net of tax, that is in all dividends totalling £170,000 net of tax. The dividends were dividends paid partly out of accumulated profits to which the provisions of s. 4 of the Finance (No. 2) Act 1955 applied.

On 31st March 1960 F.A. & A.B. Ltd. sold the 2,000 preferred ordinary shares of £1 in S. & Co. which it had acquired to U.G.S. Finance Ltd., another member of the Barro Equities group, for the sum of £455,000.

In connection with the transaction entered into by it in the said preferred ordinary shares F.A. & A.B. Ltd. incurred legal costs and stamp duty amounting in all to £3,572. Thus commercially F.A. & A.B. Ltd. sustained in respect of this transaction after taking account of net dividends received an overall loss exactly equal to such costs and stamp duty, that is, a loss of £3,572. For the purposes of claims made under s. 341 of the Income Tax Act 1952 the dividends fall to be left out of account and the trading loss claimed by F.A. & A.B. Ltd. to have been sustained by it in 1959–60 in respect of the transaction was £3,572 plus £170,000, that is, £173,572.

(*b*) *L.N.P. Ltd. transaction.*

This transaction involved forward dividend-stripping.

On 23rd March 1959 a resolution was passed at an extraordinary general meeting of L.N.P. Ltd. (a company which carried on an advertising agency) that the capital of that company be increased from £2,000 to £2,100 by the creation of 100 preferred shares of £1 each having the rights specified in a further resolution passed at the same meeting. The rights conferred on these preferred shares included, with certain qualifications, the right during a period of five years from the date of issue to all dividends declared out of profits of

(1) Not included in the present print.

A the company (other than any profits on capital account) earned subsequent to their issue and thereafter to a fixed preferential dividend at the rate of 8 per cent. per annum. The preferred shares were allotted credited as fully paid to and amongst holders of the company's ordinary shares. A copy of the resolution hereinbefore referred to is attached to the copy of the agreement set out in exhibit B(*b*)(i) annexed (1).

B On the same day Giltspur Investment & Finance Co. Ltd. (a company of which F.A. & A.B. Ltd. was then a subsidiary, hereinafter referred to as "Giltspur") entered into an agreement (set out in exhibit B(*b*)(i) annexed(1)) with Mr. Frederick Arthur Nicholson (hereinafter referred to as "Mr. Nicholson") whereby it agreed to purchase from him the 100 preferred shares of L.N.P. Ltd. for the sum of £100,000 payable at the times and in the events C and upon the terms specified therein. The agreement provided, *inter alia* (clause 2(*a*) (*b*) and (*c*)) that the £100,000 should be payable by annual instalments payable on 25th March in each year until 25th March 1963 (if not paid in full earlier), that the amount of each instalment should be a sum equal to the net dividend paid by the company on the preferred shares out of its profits for its financial year ended on 31st March prior thereto, and that the instalment D of purchase price should be a charge on the dividend so declared.

In clause 2(*b*) of this agreement the words "prior thereto" were inserted by mistake. To give effect to the intention of the parties they should have read "following the date of payment", and a deed was subsequently executed (see below) providing that the agreement should be rectified so as to take effect as if those words had been substituted for the words "prior thereto" as from E the date of its execution.

On 31st March 1959 Giltspur (which had received a dividend amounting to £15,000 net of tax payable on 25th March 1959) and F.A. & A.B. Ltd. entered into an agreement (exhibit B(*b*)(ii)(1)) whereby the latter Company agreed to purchase the 100 preferred shares for £1 subject to and with the benefit of the provisions of the agreement dated 23rd March 1959 made between F Giltspur and Mr. Nicholson.

On the same day Giltspur, F.A. & A.B. Ltd. and Mr. Nicholson entered into a deed (exhibit B(*b*)(iii)(1)) whereby Giltspur assigned to F.A. & A.B. Ltd. with the consent of Mr. Nicholson the benefit of the agreement dated 23rd March 1959 made between Giltspur and Mr. Nicholson in consideration of (i) a covenant by F.A. & A.B. Ltd. with Mr. Nicholson whereby F.A. & A.B. Ltd. G undertook to observe and perform all the obligations contained in the said agreement dated 23rd March 1959 and on the part of Giltspur to be observed and performed, and (ii) a release whereby Mr. Nicholson released Giltspur from all the obligations contained in the said agreement dated 23rd March 1959 and to be observed and performed by Giltspur.

During the year ended 31st March 1960 F.A. & A.B. Ltd. received a H dividend on the 100 preferred shares of L.N.P. Ltd. of £13,325 net of tax and F.A. & A.B. Ltd. paid to L.N.P. Ltd. as an instalment of the purchase price the same amount, that is, £13,325.

On 31st March 1960 F.A. & A.B. Ltd. sold the 100 preferred shares of L.N.P. Ltd. which it had acquired to U.G.S. Finance Ltd. for the sum of £1, subject to the taking over by U.G.S. Finance Ltd. of the obligations under I the agreement with Mr. Nicholson.

On 18th August 1961 Mr. Nicholson, Giltspur and F.A. & A.B. Ltd. entered into a further deed (exhibit B(*b*)(iv)(1)) providing that the agreement dated 23rd March 1959 made between Mr. Nicholson and Giltspur should be rectified by substituting in clause 2(*b*) thereof for the words "prior thereto"

(1) Not included in the present print.

the words " following the date of payment ", and that that agreement should take effect as if such words had been substituted therein as from the date of its execution. The deed confirmed that the instalment of the purchase price paid on 26th March 1959 was paid in accordance with the true agreement between the parties contained in the agreement as rectified.

F.A. & A.B. Ltd. paid £1 plus £13,325, that is, £13,326 in all, in respect of the 100 preferred shares, sold them for £1, and thus after taking account of the £13,325 net dividend received made neither profit nor loss on the transaction. Excluding the dividend from account for the purposes of its claim under s. 341 of the Income Tax Act 1952, the trading loss claimed by F.A. & A.B. Ltd. to have been sustained by it in 1959–60 in respect of this transaction was £13,325.

(*c*) *W. P. Ltd. transaction.*

This transaction also involved forward dividend-stripping.

The capital of W. P. Ltd. (a company carrying on theatrical activities) consisted of £1,100 divided into 100 preferred shares of £1 and 1,000 ordinary shares of £1. By resolution passed at a general meeting of W. P. Ltd. held on 11th September 1959, it was resolved to capitalise the sum of £100 in paying up in full the 100 preferred shares of £1 each and to allot them credited as fully paid to and amongst the holders of the ordinary shares in the company.

On 18th September 1959 F.A. & A.B. Ltd. entered into an agreement (exhibit B(*c*)(i) annexed[1]) with two shareholders of W. P. Ltd. (therein and hereinafter referred to as " the shareholders ") whereby it agreed to purchase from them the 100 preferred shares for the sum of £75,000 payable on completion of the sale and purchase the same day. By clause 4 of this agreement the shareholders jointly and severally undertook and warranted to the purchaser that the gross dividends paid by the company on the said preferred shares in the period from the date of execution thereof to 31st March 1961 out of profits which were not accumulated by the company prior to the date thereof within the meaning of s. 4 Finance (No. 2) Act 1955, as amended, would amount to at least £100,000, and if such dividends should for any reason whatsoever in total amount to less than £100,000 the shareholders agreed to pay to F.A. & A.B. Ltd. as damages for the breach of the warranty a sum equal to three-fourths of such deficit.

On the same day the shareholders F.A. & A.B. Ltd. and Baroque Finance Ltd. entered into an agreement (exhibit B(*c*)(ii) annexed[1]) which provided, *inter alia*, that Baroque Finance Ltd. (therein and hereinafter referred to as " the stakeholder ") would hold the sum of £50,000, being part of the purchase price of £75,000, as security for the covenants for the benefit of F.A. & A.B. Ltd. contained in the two agreements. The agreement also provided, *inter alia*, that:

> " The stakeholder shall hold the said sum of Fifty thousand pounds until such time as the net dividends received by F.A.A.B. on the said shares after deduction of tax thereon shall together with a sum equal to eleven thirty firsts of any tax recovered from the Revenue in respect thereof amount to Twenty-five thousand pounds. After such time as the total of the said sums shall equal Twenty-five thousand pounds the Stakeholder shall from time to time release to the Shareholders a part or parts of the sum held by them equal to the net amount of any dividends thereafter received by F.A.A.B. from the Company after deduction of tax thereon and a part or parts of the said sum equal to eleven thirty firsts of any tax thereafter recovered from the Revenue in respect thereof.

(1) Not included in the present print.

A If the Shareholders shall be in breach of their undertaking and warrant in Clause 4 of the Sale Agreement the Stakeholder shall pay to F.A.A.B. an amount equal to the damages for such breach as therein provided. And it is hereby agreed between the Shareholders and F.A.A.B. that any claim for damages for breach of the said undertaking and warrant shall be enforceable only out of the balance from time to time retained B by the Stakeholder under the terms of this Agreement and shall not be recoverable from the Shareholders personally save and excepting that if the net amount of the dividends received by F.A.A.B. in the said period (after deduction of tax therefrom) being dividends paid out of profits which were not accumulated by the Company prior to the date hereof within the meaning of Section 4 Finance (No. 2) Act, 1955, as amended shall C be less than Twenty-five thousand pounds a part of such damages equal to the amount by which the net dividend shall be less than Twenty-five thousand pounds shall be recoverable from the Shareholders and shall not be limited to the fund held on their behalf by the Stakeholder."

On 28th March 1960 F.A. & A.B. Ltd. received a dividend on the 100 preferred shares of W. P. Ltd. of £25,000 net of tax. On 31st March 1960 D F.A. & A.B. Ltd. sold the said 100 preferred shares to U.G.S. Finance Ltd. for the sum of £50,000.

In connection with the transaction entered into by it in the said preferred shares F.A. & A.B. Ltd. incurred legal costs and stamp duty amounting to £623. Thus commercially F.A. & A.B. Ltd. sustained in respect of the transaction after taking account of the net dividend of £25,000 received an overall loss E exactly equal to such costs and stamp duty, that is a loss of £623. Excluding the dividend from account for the purpose of its claim under s. 341 of the Income Tax Act 1952, the trading loss claimed by F.A. & A.B. Ltd. to have been sustained by it in 1959–60 in this transaction was £623 plus £25,000, that is £25,623.

(*d*) *O. I. Ltd. transaction.*

This transaction again involved dividend-stripping. There was not, F however, in this case any creation of shares with special rights.

O. I. Ltd. is an investment company which was the parent company of a group of companies carrying on business as copper processors and smelters.

On 30th March 1960 F.A. & A.B. Ltd. entered into an agreement (exhibit B(*d*)(i)[1]) with certain shareholders in O. I. Ltd. (therein and hereinafter referred to as "the principal shareholders") whereby it agreed to purchase G from them 99,702 ordinary shares, 199,404 deferred ordinary shares, and 54,851 6½ per cent. cumulative preference shares of O. I. Ltd. (being the whole of the ordinary, deferred ordinary, and preference shares of the company) for the sums of £1,168,844, £99,702 and £55,400 respectively, that is for a total sum of £1,323,946, this sum being payable on completion of the sale and purchase on the following day.

H By clause 5 of this agreement (in which F.A. & A.B. Ltd. is called "F.A. & A.B.", O. I. Ltd. is called "the Company", the Spencer Wire Co. Ltd. (a subsidiary of Elm Tree Industrial Finance Co. Ltd., a wholly-owned subsidiary of O. I. Ltd.) is called "Spencer" and Elm Tree Industrial Finance Co. Ltd. is called "Elm Tree") the principal shareholders severally and jointly undertook and warranted to F.A. & A.B. Ltd., *inter alia*, as follows:

I "(*c*) That as at the Thirty first day of March One thousand nine hundred and sixty . . . the book debts then owned by Spencer on that date shall realise a sum . . . sufficient to satisfy all liabilities of Spencer on that date . . . Provided Always that if the book debts recovered shall be more

[1] Not included in the present print.

than sufficient to satisfy the liabilities on that date F.A. & A.B. shall pay to the Principal Shareholders a sum equal to the excess as additional purchase consideration for the said Ordinary Shares hereby acquired by it. A

(*d*) That the profits of Elm Tree at the date hereof (other than profits on capital account) available for distribution by way of dividend to the Company shall be sufficient to declare a gross dividend which after deduction of tax at the standard rate in force at the date of payment shall leave the net sum of eight hundred thousand pounds and that if a dividend or dividends shall be declared at any time by the Company to F.A. & A.B. out of the said dividend so received by it F.A. & A.B. shall be entitled to and shall recover from the Commissioners of Inland Revenue either directly or by way of set off the tax deducted by the Company in paying such dividend Provided Always that if F.A. & A.B. shall fail to recover any such tax the Shareholders will pay to F.A. & A.B. by way of liquated [*sic*] damages for breach of this undertaking the difference between a sum equal to one half of the Tax recovered and the sum of Two hundred thousand pounds." B C

On the same day the principal shareholders, F.A. & A.B. Ltd. and the Anglo-Israel Bank Ltd. entered into an agreement (exhibit B(*d*)(ii) annexed([1])) which provided, *inter alia*, that the shareholders should forthwith deposit the sum of £200,000 with the Anglo-Israel Bank Ltd. (therein and hereinafter referred to as " the stakeholder "), that the stakeholder should hold that sum on behalf of the shareholders and as security for the undertaking and warranties for the benefit of F.A. & A.B. Ltd. in the two agreements and that subject to certain provisions the stakeholder should hold the sum of £200,000 upon trust to release to the shareholders that sum or a sum equal to one half of any tax recovered by F.A. & A.B. Ltd. in accordance with clause 5(*e*) of the sale agreement. The sale agreement did not in fact contain any clause 5(*e*), but it included in clause 5(*d*) thereof the provisions set out above. D E

In addition to the purchase price of £1,323,946 under the terms of the sale agreement F.A. & A.B. Ltd. incurred further expenditure in connection with the O. I. Ltd. transaction as follows: F

Cost of shares acquired in Spencer Wire Co. Ltd. (subsequently renamed Calder Vale Investments Ltd.) which were held by outside interests, that is, not owned by Elm Tree Industrial Finance Co. Ltd...	£13,200
Legal costs and stamp duty	£5,384
Additional purchase price payable under clause 5(*c*) of the sale agreement (see (*c*) above)	£336,402

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The total expenditure incurred by F.A. & A.B. Ltd. in connection with this transaction thus amounted to £1,678,932.

During the year ended 31st March 1961 F.A. & A.B. Ltd. received dividends on shares acquired by it in O. I. Ltd. amounting in all to £800,000 net of tax.

On 14th July 1961 Messrs. Cooper Bros. & Co. wrote to Barro Equities Ltd. (exhibit B(*d*)(iv) annexed([1])) setting out the combined assets and liabilities as at 31st March 1961 of O. I. Ltd. and subsidiaries thereof, but substituting the market value of the investments for the value at which they were carried in the balance sheets. The net value thus arrived at was £695,952, and in the accounts of F.A. & A.B. Ltd. for the year ended 31st March 1961 the shares held in O. I. Ltd. and its subsidiaries were written down to this figure. F.A. & A.B. Ltd. has since continued to hold these shares, the directors of Barro Equities Ltd. having been advised by Counsel that, following the enactment of s. 28 of the H I

([1]) Not included in the present print.

A Finance Act 1960, the shares in O. I. Ltd. should not be sold until the company had been advised that the disposal would not entail any adverse tax consequences.

F.A. & A.B. Ltd. had on the basis of the valuation of £695,952 as at 31st March 1961 sustained a net loss on the O. I. Ltd. transaction at that date, after taking account of the net dividends of £800,000 received, of £1,678,932 B minus £695,952 minus £800,000, that is £182,980, subject, however, to the undertaking contained in the proviso to clause 5(*d*) of the sale agreement. Excluding dividends for the purposes of its claim under s. 341 of the Income Tax Act 1952, the trading loss claimed by F.A. & A.B. Ltd. to have been sustained by it in 1960–61 in respect of this transaction was £182,980 plus £800,000, that is £982,980.

C (*e*) *B. P. Ltd. transaction.*

This transaction involved both backward and forward dividend-stripping.

The capital of B. P. Ltd. (a company formed to exploit the talents of Mr. Arthur Thomas Levi Watkins, a theatre and film writer, hereinafter referred to as " Mr. Watkins ") consisted of £300 divided into 100 5 per cent. cumulative preference shares of £1, 100 ordinary shares of £1 and 100 preferred D ordinary shares of £1. By resolution passed at a general meeting of B. P. Ltd. held on 1st April 1960, it was resolved to capitalise the sum of £100 in paying up in full the 100 preferred ordinary shares of £1 each and to allot them credited as fully paid to and amongst the holders of the ordinary shares in the company. The preferred ordinary shares conferred on their holders the right, subject to the rights of the holders of cumulative preference shares, to all dividends de-E clared by the company during the period of five years from the date of their issue.

On 1st April 1960, that is the same day, F.A. & A.B. Ltd. entered into an agreement (exhibit B(*e*)(i) annexed(1)) with Mr. Watkins, the beneficial owner of all the preferred ordinary shares, whereby it agreed to purchase those shares from him for the sum of £28,500, payable on completion of the sale and purchase F the same day. By clause 4 of this agreement Mr. Watkins undertook and warranted to F.A. & A.B. Ltd.:

> " that the aggregate net dividends after deduction of tax therefrom which shall be paid by the Company on or after completion on the Purchased Shares shall amount to at least £25,000 of which net dividends of at least £20,500 thereof shall be paid out of profits of the Company G which were not accumulated by the Company prior to the date hereof within the meaning of Section 4 Finance (No. 2) Act 1955 as amended and if such net dividends shall for any reason whatsoever in total amount to less than £25,000 [Mr. Watkins] agrees to pay to the Purchaser as damages for breach of such warranty an amount equal to 117½ per cent. of the amount by which such net dividends fall short of the said sum of H £25,000 ".

On the same day Mr. Watkins, F.A. & A.B. Ltd. and Baroque Finance Ltd. entered into an agreement (exhibit B(*e*)(ii) annexed(1)) which provided, *inter alia*, that Baroque Finance Ltd. (therein referred to as " the Stakeholder ") would hold the sum of £28,500 on behalf of Mr. Watkins and as security for the covenants for the benefit of F.A. & A.B. Ltd. contained in the two agreements. I The agreement also provided, *inter alia*, that:

> " The Stakeholder shall hold the said sum of Twenty-eight thousand five hundred pounds upon trust to release to [Mr. Watkins] a part or parts thereof equal to the net amount after deduction of tax therefrom

(1) Not included in the present print.

of any dividends declared on the Purchased Shares as and when received from the Company and to Thirty-three and one third per cent. of any tax thereafter recovered from the Revenue in respect of such dividends ". A

On 1st April 1960 F.A. & A.B. Ltd. received a dividend on the 100 preferred ordinary shares of B. P. Ltd. of £4,500 net of tax, this being a dividend paid out of accumulated profits to which the provisions of s. 4 of the Finance (No. 2) Act 1955 applied. The sum of £4,500 was then paid over to the vendor of the shares. B

In the years ended 31st March 1962, 31st March 1963 and 31st March 1964 F.A. & A.B. Ltd. received dividends on these shares amounting to £1,225 net of tax, £766 net of tax and £5,758 net of tax respectively. F.A. & A.B. Ltd. has continued to hold these shares, the reason for doing so being the same as in the case of the O. I. Ltd. shares. C

In connection with the transaction entered into by it in the said preferred ordinary shares F.A. & A.B. Ltd. incurred legal costs and stamp duty amounting to £268. On the basis of account being taken of dividends received or to be received net of tax amounting in all to £25,000, F.A. & A.B. Ltd.'s overall loss in respect of the B. P. Ltd. transaction would be £28,500 minus £25,000 plus £268, that is £3,768. D

In F.A. & A.B. Ltd.'s profit and loss accounts amounts have been written off the B. P. Ltd. shares as follows:

Year ended 31st March 1961 — £5,394 (including £268 legal costs)
Year ended 31st March 1962 — £1,396
Year ended 31st March 1963 — £873
Year ended 31st March 1964 — £6,838 E

The amount written off each year is an amount equal to the dividend net of tax received in that year together with a proportionate part of the overall loss of £3,768. The trading losses claimed by F.A. & A.B. Ltd. to have been sustained by it for the purposes of its claim under s. 341 for the years 1960–61 and 1961–62 in the B. P. Ltd. transaction on the basis of not crediting dividends received are the amounts which were written off in those years, that is £5,394 and £1,396 respectively. F

(5) The five transactions involving dividend-stripping summarised in the preceding sub-paragraph were entered into by F.A. & A.B. Ltd. with the object of making money, bearing in mind the fiscal advantages which it was expected would flow from the transactions. In relation to S. & Co., W. P. Ltd., O. I. Ltd. and B. P. Ltd. the transaction in each case would produce a loss to F.A. & A.B. Ltd. unless repayment of income tax was obtained, and in relation to L. N. P. Ltd. there could be no profit to F.A. & A.B. Ltd. without such a repayment. G

6. The following cases were referred to: *J. P. Harrison (Watford) Ltd.* v. *Griffiths* 40 T.C. 281; [1963] A.C.1;—*Petrotim Securities Ltd.* v. *Ayres* 41 T.C. 389; [1964] 1 W.L.R. 190; *F. S. Securities Ltd.* v. *Commissioners of Inland Revenue* 41 T.C. 666; [1965] A.C. 631; *Ridge Securities Ltd.* v. *Commissioners of Inland Revenue* 44 T.C. 373; [1964] 1 W.L.R. 479; *Finsbury Securities Ltd.* v. *Bishop* (C.A. 7th July 1965)[1]. H

7. It was contended on behalf of the Inspector of Taxes:

(1) that the transactions whereby F.A. & A.B. Ltd. acquired shares in S. & Co., L. N. P. Ltd., W. P. Ltd., O. I. Ltd. and B. P. Ltd. were not transactions entered into by F.A. & A.B. Ltd. in the course of trade; I

(2) that the shares in these companies acquired by F.A. & A.B. Ltd. did not at any time form part of F.A. & A.B. Ltd.'s stock-in-trade;

(1) 43 T.C. 591; [1965] 1 W.L.R. 1206.

A (3) formally, but without argument, that the four transactions involving forward dividend-stripping were not trading transactions because they necessarily involved acquisition with a view to holding and so were akin to investments;

(4) that in relation to the L. N. P. Ltd. transaction the cost to F.A. & A.B. Ltd. of the shares acquired by it in L. N. P. Ltd. did not in any event include the sum of £13,325 which would have been payable by Giltspur for B those shares if the transaction had been carried through by that company.

8. It was contended on behalf of the Respondent:

(1) that the shares which it acquired in S. & Co., L. N. P. Ltd., W. P. Ltd., O. I. Ltd. and B. P. Ltd. were acquired by it in the course of its trade as a dealer in stocks and shares and formed part of its stock-in-trade;

(2) that in relation to the L. N. P. Ltd. transaction the sum of £13,325 C paid by the Respondent formed part of the cost to it of the shares which it acquired in L. N. P. Ltd.;

(3) that the claims made by the Respondent under s. 341 of the Income Tax Act 1952 for the years 1959–60, 1960–61 and 1961–62 should accordingly be allowed.

9. We, the Commissioners who heard the appeal, took time to consider D our decision, and as respects questions which are still in issue between the parties gave it in writing on 1st September 1965 as follows[1]:

(1) The appeal by F.A. & A.B. Ltd. before us relates to an assessment made upon the Company for the year 1960–61 and claims preferred by the Company under s. 341 of the Income Tax Act 1952 for the years 1959–60, 1960–61 and 1961–62. As regards both the assessment and the claims under appeal E the primary question for our determination is whether or not certain shares acquired by the Company were acquired by it in the course of its trade as a dealer in stocks and shares (hereinafter referred to as dealing in shares) and accordingly formed part of its stock-in-trade.

(2) The shares in question were shares which F.A. & A.B. Ltd. acquired in Sotheby & Co., Leggett Nicholson & Partners Ltd., Western Productions Ltd., F Oakroyd Investments Ltd., Balcombe Productions Ltd. . . . The transactions in shares entered into by F.A. & A.B. Ltd. in relation to each of these companies . . . were dividend-stripping transactions . . .

(3) As regards the five transactions involving dividend-stripping, the dividend-stripping transactions which were in issue in *J. P. Harrison (Watford) Ltd.* v. *Griffiths* 40 T.C. 281 and *Finsbury Securities Ltd.* v. *Bishop* (Court of G Appeal, 7th July 1965)[2] were held to be within the scope of a trade of dealing in shares. Bearing in mind the opinions given in the House of Lords in the former, and the judgments given in the Court of Appeal in the latter, of these cases, we find on the evidence adduced before us in the present case that the five dividend-stripping transactions entered into by F.A. & A.B. Ltd. formed part of that Company's trade of dealing in shares.

H (4) . . .

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[1] The omissions indicated by dots were made by the Commissioners in stating the Case.
[2] 43 T.C. 591.

(5) We conclude accordingly that F.A. & A.B. Ltd. is entitled for the years 1959–60, 1960–61 and 1961–62 to relief from tax under s. 341 of the Income Tax Act 1952 on an amount of its income equal to the amount of any loss sustained by it for those years in its trade of dealing in shares, such loss being computed on the basis that the above-mentioned transactions formed part of that trade.

(6) In relation to the transaction in shares of Leggett Nicholson & Partners Ltd. the further question arises whether the cost of the shares to F.A. & A.B. Ltd. did or did not include the £13,325 which, had the transaction been carried through by Giltspur Investment & Finance Co. Ltd. (hereinafter referred to as " Giltspur "), would have been payable by that company for the shares and been a charge on the net dividend received. On this we take the view that, on the true construction of the agreement dated 31st March 1959 made between Giltspur and F.A. & A.B. Ltd. and the deed of the same date made between those companies and Frederick Arthur Nicholson, F.A. & A.B. Ltd. took over, *inter alia*, Giltspur's obligations as to payment for the shares contained in the agreement dated 23rd March 1959 made between the said Frederick Arthur Nicholson and Giltspur, and that the cost to F.A. & A.B. Ltd. of the shares did accordingly include the sum of £13,325 in question.

(7) We leave figures to be agreed accordingly.

10. On 25th November 1965, figures having been agreed between the parties on the basis of our decision, we determined the appeal accordingly by discharging the assessment made upon the Respondent for the year 1960–61 and determining the amounts of the trading losses for s. 341 purposes sustained by the Respondent as follows:

1959–60	£46,644
1960–61	£1,016,477
1961–62	£15,425

11. H.M. Inspector of Taxes immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law, and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Management Act 1964, s. 12(5), and the Income Tax Act 1952, s. 64, which Case we have stated and do sign accordingly.

12. The question of law for the opinion of the Court is whether there was evidence on which we could come to the conclusion set out in para. 9(5) of this Case, and if so whether our decision set out in para. 9(6) thereof is correct.

G. R. East } Commissioners for the Special Purposes of the

G. R. East } Commissioners for the
B. James } Special Purposes of the Income Tax Acts

Turnstile House,
94–99 High Holborn,
London, W.C.1.
6th February 1967.

The case came before Megarry J. in the Chancery Division on 25th, 26th and 27th March 1968, when judgment was given in favour of the Crown, with costs.

A *H. H. Monroe Q.C.*, *J. Raymond Phillips* and *J. P. Warner* for the Crown.

F. Heyworth Talbot Q.C. and *Michael Nolan* for the Company.

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

Megarry J.—This is a Case stated by the Special Commissioners. It relates to relief claimed by a company, F.A. & A.B. Ltd. (which I shall call " the B Company "), under s. 341 of the Income Tax Act 1952 in respect of the years 1959–60, 1960–61 and 1961–62. The claim relates to losses in the Company's trade as a dealer in stocks and shares. It is accepted on all hands that during these years the Company was trading as a dealer in stocks and shares. Throughout there has been no suggestion that any of the transactions concerned were shams or in any way other than they appeared to be.

C The case relates to five transactions involving dividend-stripping—for the most part forward dividend-stripping, but in some cases involving some backward dividend-stripping. The Special Commissioners found that in each case the Company entered into the transactions

> " with the object of making money, bearing in mind the fiscal advantages which it was expected would flow from the transactions ".

D The Special Commissioners found that these transactions formed part of the Company's trade of dealing in shares, and upon this footing held that the trading losses for the three years were for 1959–60 £46,644; for 1960–61 £1,016,477, and for 1961–62 £15,425. The question of law, which is more fully stated in paras. 9(5) and (6) and 12 of the Case Stated, is, shortly, whether there was evidence upon which the Special Commissioners could come to this E conclusion. Both sides accept that the question for this Court is one of law, as, indeed, the *Finsbury* case to which I am about to refer goes far to establish: [1966] 1 W.L.R., at page 1411(1).

Much of the argument in the case has turned on two decisions of the House of Lords on dividend-stripping, *J. P. Harrison* (*Watford*) *Ltd.* v. *Griffiths*(2) [1963] A.C. 1 and *Finsbury Securities Ltd.* v. *Bishop*(3) [1966] 1 W.L.R. 1402. F The *Harrison* case, which was decided by a majority of three to two in favour of the taxpayer, was duly considered by the Special Commissioners. On the other hand, the *Finsbury* case, a decision in favour of the Crown, had not been decided by the House of Lords at the time, and the Special Commissioners had before them only the majority decision of the Court of Appeal in favour of the taxpayer(4), a decision which the House of Lords was later unanimously G to reverse.

I will take the facts of the first of the five transactions as an example of the problem. This, next to the fourth transaction, was the transaction which Mr. Heyworth Talbot, for the Company, selected as being most favourable to his case, a selection with which Mr. Monroe, for the Crown, agreed. The facts are fully set out in the Case, and I refer to the essentials only. It concerns the firm of H Sotheby & Co., which is an unlimited company. The first step was that on 21st December 1959 Sothebys held an extraordinary general meeting, and at that meeting a resolution to increase the capital by creating 2,000 preferred ordinary shares of £1 each was duly passed. The shares themselves were extraordinary to the extent that, subject to the dividends payable on Sothebys' preference shares, the new shares for a period of five years carried all dividends out of the profits I of the company (other than profits on capital account), and thereafter became

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(1) 43 T.C. 591, at p. 622. (2) 40 T.C. 281. (3) 43 T.C. 591. (4) [1965] 1 W.L.R. 1206.

(Megarry J.)

fixed non-cumulative preference shares carrying a dividend of 8 per cent. Further, on liquidation there was to be a repayment of the amount paid up and no more. It was also provided that Sothebys could at any time cancel the shares upon paying the shareholders an amount equal to the amount paid up on the shares. The shares carried no other rights as to voting or otherwise. These new shares were duly allotted, credited as fully paid, among the holders of the ordinary shares.

The next day, 22nd December 1959, the Company entered into a contract with the nine shareholders in Sothebys for the purchase of these 2,000 shares for £625,000 cash down, with completion that day. The shareholders undertook and warranted to the Company that interim dividends of £125,000 net of tax would be declared in respect of the current accounting period ending 31st December 1959 and would be paid to the Company within seven days of completion. There was also a warranty that further dividends would be paid to the Company during the five years from the date of the contract amounting (net of tax) to £500,000; and there was an agreement to pay to the Company as liquidated damages for breach of warranty a sum equal to any shortfall, with a further sum if less than £100,000 was paid. On the same day the Company, the shareholders and a company called Northern Holdings Ltd. made a contract whereby Northern Holdings Ltd. (who were described as " the stakeholder ") were to hold £500,000 out of the £625,000 paid by the Company. This was to be held on behalf of the shareholders, and also as security for the undertaking and warranty for the benefit of the Company. As and when dividends were paid in excess of the initial £125,000 the stakeholder was to release equivalent amounts out of the £500,000 to the shareholders; and if there was any breach of warranty by the shareholders the stakeholder was to pay the Company the damages out of the £500,000. By a letter to the Company dated the same day, Hambros Bank Ltd. undertook to extend sufficient facilities to the stakeholders to enable them to carry out their obligations under the agreement.

Between then and 31st March 1960 Sothebys declared dividends which were paid to the Company amounting to £170,000 net of tax. These dividends consisted of the £125,000 together with £45,000 more. On 31st March 1960 the Company sold the shares to another company called U.G.S. Finance Ltd. for £455,000. Both the Company and U.G.S. Finance Ltd. were members of a group of companies of which Barro Equities Ltd. was the parent company. The Company incurred legal costs and stamp duty amounting to £3,572. Commercially, the result of the course of dealing was that the Company received net dividends of £170,000 and sold the shares for £170,000 less than the Company had paid for them, so that the net loss was merely the expenses of £3,572. But for the purpose of s. 341 the dividends (which had already suffered deduction of tax) must be ignored, and so the loss claimed is £173,572. If that sum is a " loss " which the Company has sustained " in any trade . . . carried on by " the Company within s. 341, the claim is valid. The question is whether it is such a loss. By s. 526(1) of the Act, except so far as is otherwise provided or the context otherwise requires, " trade " includes " every trade, manufacture, adventure or concern in the nature of trade ". The term " trade " is thus left undefined; for this provision relates to the ambit of the word " trade " rather than its meaning, and if it were to be treated as a definition it would be open to the valid semasiological thrust that there is little profit in seeking to define a word in terms of itself.

I now turn to the two leading cases of *Harrison*[1] and *Finsbury*[2]. In *Harrison* the company bought all the shares in C Ltd. for £16,900. C Ltd.

(1) 40 T.C. 281. (2) 43 T.C. 591.

A declared a net dividend of some £15,900, and the company then sold the shares for £1,000, claiming a loss of £15,900 for the purposes of s. 341. The Special Commissioners held that this was not a trading loss, but Danckwerts J., the Court of Appeal (with Donovan L.J. dissenting) and the House of Lords (with Lord Reid and Lord Denning dissenting) all held that they were wrong. Lord Simonds said this, [1963] A.C., at page 11([1]):

B " I hope that I do no injustice to the argument for the Crown if I say that it rested entirely on the proposition that the essence of a trading transaction is that its object is to make a profit and that the found object of this transaction was the ulterior one of obtaining a dividend against which it could claim to set off its losses."

This contention he rejected, and held that a transaction could perfectly well be a C trading transaction even though it made and was intended to make a loss. On this point I may observe that during the argument of this case examples were taken such as the well-known " loss leaders " which certain supermarkets offer for sale, being goods upon which no profit, or indeed an outright loss, will be made, in the hope that the attractions of these goods will bring customers to the store who will purchase other goods which will show the store a profit. Again, D the instance was taken of a company trading at a loss under difficult commercial conditions because it wishes to keep its experienced staff together and has future developments in mind which it hopes will shortly restore its profits, if only it still has that staff. Lord Simonds also said this, at page 12([2]):

" It appears to me to be wholly immaterial, so long as the transaction is not a sham . . . what may be the fiscal result or the ulterior fiscal object of E the transaction, and since this can be the only ground upon which the Commissioners could have reached their determination, I must conclude that it cannot be upheld. "

He thus rejected the test of looking to see whether the purpose of the transaction is a fiscal purpose. Lord Morris of Borth-y-Gest, at page 23([3]), says this:

" . . . it seems to me that a trading transaction does not cease to be F such merely because it is entered into in the confident hope that, under an existing state of the law, some fiscal advantage will result. In judging as to the essential nature of a transaction it will often be relevant and of assistance to consider the objects and intentions which are the inspiration of the transaction. In the present case, however, I cannot think that there is room for doubt as to the essential nature of the transaction: it was a G transaction which was demonstrably of a trading nature and it was not divested of that nature merely because it was entered into with the expectation that as a result (but not as part of the trading activity of the Company as such) some tax recovery might be claimed. "

Lord Guest, at page 26([4]), said that it

" by no means follows that the absence of an intention to make a profit H or the intention to make a loss negatives trading. The test is an objective one. The question to be asked is, not *quo animo* was the transaction entered into, but what in fact was done by the Company ". He added, at page 27([5]), that in his opinion " one has to look at the transaction by itself irrespective of the object, irrespective of the fiscal consequences, and ask the question in Lord President Clyde's words in *Commissioners of*

([1]) 40 T.C. 281, at p. 293. ([2]) *Ibid.*, at p. 294. ([3]) *Ibid.*, at p. 301. ([4]) *Ibid.*, at p. 304. ([5]) *Ibid.*

(Megarry J.)

> *Inland Revenue* v. *Livingston*(1): ' whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made'. "

It seems to me that this is a narrow decision on a narrow point. The case merely decides that a transaction is not prevented from being a trading transaction merely because its object is not to make a trading profit but to obtain a tax advantage. The transaction involved was a simple transaction of purchasing, reaping the dividend and selling. It involved no superstructure of specially created shares of an extraordinary nature or warranties or a stakeholder or the like. So far as the purpose of the transaction is concerned, it appears that Lord Simonds and Lord Guest were taking the view that this had to be disregarded, whereas Lord Morris said that it was often relevant. A possible answer, simply on that decision alone, might be this: that if, as in that case, the nature of the transaction is clear, then the object or purpose does not affect it, but that if the nature of the transaction is less than clear then it may be permissible to look at the objective in order to explain the nature of the transaction.

In the *Finsbury* case(2) the headnote (3) summarises the arrangement in the majority of the fifteen cases in question in the following way:

> " The company to be ' stripped ' created a small number of preference shares which, in addition to a normal fixed interest dividend, were to carry, for short periods of years, special net dividends amounting to the whole of the company's anticipated net profits from its business for the period of years, up to a stated maximum. The respondent thereupon bought those shares, the purchase price being the stated maximum (which was to be reduced to the extent that the special dividends over the period fell below that maximum) plus one-half of any referable tax repayments on any loss claim established by the respondent under section 341. Each year the value of the shares fell by reason of the dividends paid. In the minority of the 15 cases the respondent bought the shares of a company having one asset which it expected to turn into a profit in about a year, and the respondent took that profit in the form of a dividend, leaving the shares with a nominal value only. "

The Special Commissioners in that case held that the case was not distinguishable from the *Harrison* case(4), and found for the company on this point. Buckley J. upheld this decision, and in the Court of Appeal the decision was affirmed on somewhat different grounds, Lord Denning M.R. dissenting. The House of Lords unanimously allowed the appeal by the Crown, and all their Lordships concurred in the speech delivered by Lord Morris of Borth-y-Gest. In that speech, [1966] 1 W.L.R., at page 1416(5), he distinguished the *Harrison* case on the ground that the arrangements there were essentially different. There

> " the transaction was demonstrably a share-dealing transaction. Shares were bought: a dividend on them was received: later the shares were sold. "

Lord Morris went on to deal with the question of motive. He said this:

> " There may be occasions when it is helpful to consider the object of a transaction when deciding as to its nature. In the *Harrison* case my view was that there could be no room for doubt as to the real and genuine nature of the transaction. The fact that the reason why it was entered into

(1) 11 T.C. 538, at p. 542; 1927 S.C. 256. (2) 43 T.C. 591. (3) [1966] 1 W.L.R., at pp. 1402–3. (4) 40 T.C. 281. (5) 43 T.C., at p. 627.

A was that the provisions of the revenue law gave good ground for thinking that welcome fiscal benefit could follow did not in any way change the character of the transaction."

It seems to me that Lord Morris is there saying that if, looking at the transaction, it is clear that it is or is not a trading transaction, motive is irrelevant. In choosing what dealings to transact a trader does not cease to trade merely B because he prefers to transact those dealings which are fiscally beneficial and to reject those that lack this advantage. The discovery of a motive for carrying out a transaction must not be confounded with an analysis of the nature of the transaction itself.

What then are the "occasions when it is helpful to consider the object of a transaction when deciding as to its nature"? (I again quote the words of Lord C Morris.) I do not think that it can merely be that the transaction is unusual or extraordinary. The question under s. 341 is not that of a loss in any "ordinary trade" but that of a loss in a "trade" *simpliciter*; and many transactions, though clearly extraordinary, are none the less trading transactions. Nor, for the reasons that I have just given, do I consider that the test can be whether the transaction would have been entered into if there had been no question of tax D advantage; in any case that would, I think, be contrary to the *Harrison* case(1). But if, when the constituent elements of a transaction are examined, it is found that there are many elements the presence of which cannot be explained on any sensible trading ground but which are readily intelligible on fiscal grounds, then, in my judgment, the fiscal grounds may become relevant; for the fiscal element has invaded the transaction itself, moulding and explaining it, and is not merely E the purpose or object for which a trading transaction is carried through.

I think this view gains some support from the words of a strong Board of the Judicial Committee in a Privy Council case from Ceylon, *Iswera* v. *Commissioner of Inland Revenue* [1965] 1 W.L.R. 663. There, in considering the words "every trade and manufacture, and every adventure and concern in the nature of trade" in what was said to be a definition of "trade", Lord Reid, speaking for F the Board, said this, at page 668:

> "If, in order to get what he wants, the taxpayer has to embark on an adventure which has all the characteristics of trading, his purpose or object alone cannot prevail over what he in fact does. But if his acts are equivocal his purpose or object may be a very material factor when weighing the total effect of all the circumstances."

G As in all such cases, it may well be difficult to draw the line. At one extreme lies a transaction which is merely a trading transaction. In such a case the transaction is not deprived of its trading nature merely by the presence of a fiscal motive for carrying it out, nor by the fact that as a trading transaction it makes a loss and not a profit. That, in the barest of outlines, is the *Harrison* case. At the other extreme lies the transaction that is far removed from H trading, designed to secure a tax advantage. There the mere fact that the transaction includes the purchase and sale of shares by a trader in shares does not in itself suffice to make it a trading transaction. That, again in the barest of outlines, is the *Finsbury* case(2). Between those two extremes lies a continuous spectrum of possible transactions in which the elements of trading become smaller and smaller in relation to the elements of securing a tax advantage. A

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(1) 40 T.C. 281. (2) 43 T.C. 591.

(Megarry J.)

sufficiency of reported cases may in due course provide the co-ordinates which will make it possible to plot the position of the dividing line; but in this case I am not required to do more than decide whether these transactions fall on the right side or the wrong side of any reasonable line that could be drawn. A

In doing that, it seems to me that I must have regard to the following principles. If upon analysis it is found that the greater part of the transaction consists of elements for which there is some trading purpose or explanation (whether ordinary or extraordinary), then the presence of what I may call " fiscal elements ", inserted solely or mainly for the purpose of producing a fiscal benefit, may not suffice to deprive the transaction of its trading status. The question is whether, viewed as a whole, the transaction is one which can fairly be regarded as a trading transaction. If it is, then it will not be denatured merely because it was entered into with motives of reaping a fiscal advantage. Neither fiscal elements nor fiscal motives will prevent what in substance is a trading transaction from ranking as such. On the other hand, if the greater part of the transaction is explicable only on fiscal grounds, the mere presence of elements of trading will not suffice to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an artificial structure, remote from trading and fashioned so as to secure a tax advantage, the mere presence in that structure of certain elements which by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure. In speaking of the greater part of the transaction I am not, of course, referring to mere bulk. A long document, like a long speech, may do and say remarkably little. What seems to me to be of particular importance is the relative extent of the significant provisions which are made. B C D E

One may look at matters in a slightly different way. I think that some assistance might be gained from considering the comment which a hypothetical, sapient and impartial trader in shares would make when confronted with the details of a transaction. Is he to be imagined as saying: " That's obviously share trading ", or perhaps: " What an unusual but interesting way of share trading ", or would he exclaim: " Whatever that is, it is not share trading "? If he were to be endowed with the qualities of a professional accountant as well, perhaps the answers might be rephrased as: " That's an adventure or concern in the nature of trade ", on the one hand, and on the other: " If this can be called an adventure or concern at all, its nature is a tax-recovery device remote from trade ". F G

With these considerations in mind I must deal with certain submissions made by Mr. Heyworth Talbot. In the forefront of his argument was his emphasis upon the differences between the facts of the present case and those in the *Finsbury* case(1). There the vendors of the shares were to have half of the tax recovered, so that the sale price would be augmented, and the transaction was at least in part for their benefit. Here there was a fixed sale price in each of the five cases, he said, with no provision for augmentation out of any tax recovered. Only in two cases did the tax recovery affect the vendors, and then only to accelerate the payment of the instalments to the vendors. Secondly, he said that in the *Finsbury* case there was an obligation on the company (which seems to have been a contractual obligation) to hold the shares for the mutual benefit of vendors and purchaser. Here there is no such obligation. Mr. Heyworth Talbot carefully analysed the speech of Lord Morris, [1966] 1 W.L.R. 1402, at page H I

(1) 43 T.C. 591.

A 1417[1], and urged with force and clarity that, as there were these differences, the *Finsbury* case[2] did not apply and the present case therefore fell within the embrace of the *Harrison* case[3]. With all proper decorum he submitted that it was not for me to say whether the facts of this case sufficed to distinguish it from the *Harrison* case: once he had demonstrated that the facts of this case were significantly different from those of the *Finsbury* case, it must be left to the B House of Lords to say whether those facts justified another exception or qualification being made to the principles of the *Harrison* case to stand side by side with the *Finsbury* case.

I hope that I do not fall too gravely below Mr. Heyworth Talbot's accustomed standards of courtesy when I say I have never met this approach to the doctrine of precedent before, and I hope never to meet it again. In my C judgment, it is plainly heterodox. As I conceive it, my duty is to distil from the authorities the principles of law laid down in them and then to apply those principles to the case before me, whatever the facts. Principles, not facts, are the life of the doctrine of precedent; and to those who seek to apply the doctrine by matching fact against fact, I would say *qui haeret in litera haeret in cortice.* Certainly I do not read the *Finsbury* decision as saying that, when the particular D facts of that case exist, then to that extent, and to that extent only, an inroad is made upon the *Harrison* rule. That would accord to the *Harrison* case an unwarranted paramountcy, and in saying that, I do not forget that the pronouncement in the House of Lords which modified the former practice of treating the House as being strictly bound by its own decisions ([1966] 1 W.L.R. 1234) was made immediately before judgment in the *Finsbury* case was delivered. As I E see it, my duty is to apply the principles that I find in the two cases when fairly read together. As I have already indicated, I consider that the *Finsbury* case is far broader in its principles than Mr. Heyworth Talbot would have me recognise. The facts of that case mentioned on page 1417[4] were the foundation for the decision of the House of Lords that the transactions were not in the nature of trade but were solely artificial devices remote from trade to secure a tax advan- F tage. Other facts in other cases may well reveal that other transactions merit the same classification; and if they do, I conceive it the duty of any court or tribunal, however lowly, to say so. It would be wrong to confound the facts of a case in which a principle emerges with the principle itself.

In this view, I derive some comfort from the judgment of Buckley J. in *Cooper* v. *Sandiford Investments Ltd.*[5] [1967] 1 W.L.R. 1351, a case upon which G Mr. Monroe relied but Mr. Heyworth Talbot abstained from comment. The facts there were very different; but the learned Judge had the two House of Lords decisions before him, and in reaching his conclusion that the case before him was on the *Finsbury* side of the line he relied upon three main points. These were, first, the complexity of the transactions; secondly, the fact that it was manifest that there would be a loss unless the transactions were held to be H trading transactions; and thirdly, that the scheme would be profitable only if the shares were held until the scheme was worked out.

> " These considerations ", he said, at page 1361[6], " all seem to me to indicate not merely that this was not an ordinary trading transaction, but that it was a transaction entered into with the primary, and indeed the only, object of obtaining a profit by means of the fiscal consequences which will I flow from the scheme if the company's claims can be substantiated. In other words the shares in Fragmap were not acquired by Sandiford in order

(1) 43 T.C. 591, at p. 627. (2) 43 T.C. 591. (3) 40 T.C. 281. (4) 43 T.C., at pp. 626–7.
(5) 44 T.C. 355. (6) *Ibid.*, at p. 365.

(Megarry J.)

to derive a profit in the course of carrying on their business of traders in securities, but were acquired in order to obtain a profit from them in consequence of the fiscal consequences which, if the company's claims are right, will result in a profit. If, however, their claims are not sustainable the transaction will involve Sandiford in a loss. These considerations, in my judgment, deprive this transaction of the character of a trading transaction. It becomes, I think, much more like what the House of Lords had to consider in the *Finsbury Securities* case(1) and is appropriately described as an artificial device remote from the company's trading activities, designed to secure a tax advantage. It was, in my judgment, a transaction into which Sandiford would never have entered at all but for the hope that it would result in fiscal advantages." A B

These last words, I think, clearly relate not merely to motive but also to the shape of the transaction itself. C

Like Buckley J., I would regard the constituent parts of each of these transactions with which I am concerned "as part and parcel of one composite transaction": I take this phrase from page 1357(2). So regarded, the question for me is whether these five transactions are on the *Harrison*(3) side of the line or the *Finsbury* side. In each case there is a somewhat elaborate structure of dealings. That by itself would not necessarily take the transactions out of the category of trading, for there may be trading transactions of great complexity. Indeed, at one stage of the argument Mr. Heyworth Talbot roundly asserted that the greater the complexity the more assured it was that there was trading. I would agree with him if the complexity is a trading complexity. For in my view the answer to his assertion is that complexity *per se* proves little: what matters is the kind of complexity. A complexity of trading provisions will reinforce the trading nature of a trading transaction; a complexity of fiscal provisions will subtract from it. D E

Here there is little or no explanation for the inclusion of some of the provisions other than fiscal advantage. The Special Commissioners have found that F

"the five transactions involving dividend-stripping summarised in the previous sub-paragraph were entered into by F.A. & A.B. Ltd. with the object of making money, bearing in mind the fiscal advantages which it was expected would flow from the transactions. In relation to S. & Co., W.P. Ltd., O.I. Ltd. and B.P. Ltd. the transaction in each case would produce a loss to F.A. & A.B. Ltd. unless repayment of income tax was obtained, and in relation to L.N.P. Ltd. there could be no profit to F.A. & A.B. Ltd. without such a repayment." G

The wording of this finding might perhaps have been more explicit, but, read fairly, I think it is reasonably plain that the Special Commissioners are saying that the sole purpose of the transactions was to obtain the fiscal advantages that they would confer. I find this far from surprising; and on this footing it is not unexpected to find that the fiscal objective has failed to remain aloof and on the horizon, and has thrust into the transactions substantive provisions designed to achieve the fiscal purpose. H

Secondly, although there is no contractual requirement that the shares should be retained for any particular period, the arrangements are such that, in order to reap the full fiscal benefit for the vendor and the Company alike, the I

(1) 43 T.C. 591. (2) 44 T.C. 355, at p. 361. (3) 40 T.C. 281.

A shares must be retained by the Company, or by a member of the Company's group, for a substantial period which will allow the scheme to work itself out. In three cases there is a maximum period of five years, and in one, the W.P. Ltd. case, it was about a year and a half. In the remaining case, that of O.I. Ltd., there is no such period. In the four cases if during the period of the scheme the shares were sold outside the group the tax advantage would to this extent be B lost. Accordingly, the carrying out of the scheme renders the shares less readily saleable; and this can hardly be a characteristic of trading in shares. Thirdly, in all the cases except one (that of O.I. Ltd.) the scheme involved the creation of special shares which carried special rights as to dividends, supported by an arrangement which by warranties or otherwise secured the payment of stated amounts by way of dividend.

C I do not think that the right approach is, after analysing each transaction meticulously, to compare the constituent elements with those present or absent in other cases, and then to decide the matter on the degree of correspondence or divergence. Instead, I consider that each arrangement should be regarded as a whole in the light of the principles which I have derived from the cases. If at the end of the day a transaction, viewed as a whole, appears to be merely or sub- D stantially a trading transaction, then despite the presence of fiscal elements or fiscal motives a trading transaction it remains. If, on the other hand, the transaction as a whole appears to be no trading transaction but an artificial device remote from trade to secure a tax advantage, then the presence of trading elements in it will not secure its classification as a trading transaction. When I look at the matter in that light, and bear in mind the documents in each trans- E action, which I have carefully re-read in the light of the arguments advanced before me, I reach the clear conclusion that four out of the five transactions (that is, all except the O.I. Ltd. case) are not trading transactions but tax devices. I would accordingly in those four cases reverse the decision of the Special Commissioners, who, of course, lacked my advantage of being able to consider the decision of the House of Lords in the *Finsbury* case[1].

F That leaves me with the O.I. Ltd. case. This differs from the other cases in the manner that I have indicated. Mr. Monroe has pointed to certain elements in the O.I. Ltd. case which nevertheless suffice, he says, to bring it into the same category as the other four. What he relied upon was primarily clause 5(*d*) of the sale agreement, which contains what is in effect a warranty of obtaining tax recovery up to an amount of £200,000. This provision is supported by the G provisions of clause 9(*b*), and is further supported by clause 3 of the stakeholding agreement[2]. Mr. Monroe accepted that there was no period of duration written into the agreement, other than a provision in the stakeholding agreement which released the stakeholder after a period of three years. Apart from these elements he was able to point to nothing in the transaction (except, of course, the general motive and purpose of the dealing) which put it into the same category as H the other four. The short question, which I have found difficult, comes to whether the significance of the provisions he has referred to, viewed in the context of the transaction as a whole, is sufficient to put the case into the same category as the others. My mind has fluctuated more than once in the course of the argument, but in the end, though I confess with some hesitation, I have come to the conclusion that these provisions are of sufficient significance to achieve I this result; and accordingly the decision in that case will be the same as in the others.

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(1) 43 T.C. 591. (2) *See* pages 621–2 *post*.

(Megarry J.)

Finally, I must mention one other point, which Mr. Heyworth Talbot advanced with what in the circumstances may equally be described as appropriate force and appropriate diffidence. In the first and fifth of the transactions, he said, the Special Commissioners had held that: A

> "the dividends were dividends paid partly out of accumulated profits to which the provisions of s. 4 of the Finance (No. 2) Act 1955 applied."

I read from the statement in the first of the cases; the statement in the fifth is almost identical. this, he said, showed that the transactions were trading transactions: the Crown could hardly apply the section to a part of the profits and in the same breath say that the transactions were not trading transactions. The answer, I think, lies in the terms of s. 4(1) of the Act of 1955. There is nothing in the section to confine it to cases where the profits were acquired by means of a trading transaction. True, the section is confined in its application to those who are engaged in a trade consisting of or comprising dealings in shares or other investments; but it is not, at any rate in terms, limited to acquisitions made by way of trading in shares. The subsection speaks as to the activities carried on by the person acquiring the shares, and not as to the mode of acquisition of those shares. All that is required is that the shares should have been sold or issued to him or otherwise acquired by him within certain limits of dates. In such cases the section bites; and a dealer in shares should accordingly have a care in acquiring for any purpose, whether or not for resale or other dealings, any shares to which the section can apply. In any case, I very much doubt whether the Special Commissioners were intending to do more than say that the accumulated profits were profits of a type which fell within s. 4; and I would not attempt in this oblique way to spell out of their words a finding as to the mode of acquisition. Even if there were such a finding, I may add, it might be wrong in law. I do not think there is anything in this point save the initial elegance of what, on examination, emerges as a fallacious dilemma. B C D E

Monroe Q.C.—My Lord, on this basis would your Lordship then allow the appeal with costs? And it seems appropriate to restore the assessment for 1960–61 which was discharged by the Commissioners, and to remit the case to the Commissioners to adjust the assessment for that year and the claims for relief for the three years in the light of your Lordship's judgment. F

Talbot Q.C.—I entirely agree, my Lord; that must follow. That is the correct form. I think my friend did mention costs?

Monroe Q.C.—I did mention costs, I am afraid.

Talbot Q.C.—I expected he would. G

Megarry J.—Yes. That was the first thing he said, Mr. Heyworth Talbot.

The Company having appealed against the above decision so far as it related to the transaction in the shares of Oakroyd Investments Ltd. ("O.I. Ltd."), the case came before the Court of Appeal (Lord Denning M.R. and Sachs and Phillimore L.JJ.) on 21st and 22nd April 1969, when judgment was reserved. On 14th May 1969 judgment was given in favour of the Crown, with costs (Sachs L. J. dissenting). H

A *S. W. Templeman Q.C.* and *Michael Nolan Q.C.* for the Company.

H. H. Monroe Q.C., J. Raymond Phillips Q.C. and *J. P. Warner* for the Crown.

Cooper v. *Sandiford Investments Ltd.* 44 T.C. 355; [1967] 1 W.L.R. 1351 was cited in argument in addition to the cases referred to in the judgments.

B **Lord Denning M.R.**—The Legislature has recently killed dividend-stripping, but this is one of its death struggles. The strippers seek to make the Revenue pay them £400,000. So it is worth fighting about.

As usual, the financial transactions are very complicated. They have to be if they are to succeed. Simple traders cannot manage them. Nor can the general run of accountants or lawyers. It needs a specialist dividend-stripper C to do it. The Company, F.A. & A.B. Ltd., were experts. That is apparent from the five transactions described in the Case Stated. In all five of them, Megarry J. found that they were not trading transactions, but tax devices and nothing else. So the Company received nothing. The Company accepted his decision in four of them. They appeal in the fifth. This depends so much on the facts that I must explain them as best I can.

D In the years up till 1959 a group of private companies called the Spencer Wire group carried on business as copper processors and smelters. The shareholders were all members of a family named Gill. The group had prospered exceedingly. They had made large profits, on which they had paid tax. But they had not paid those profits to the shareholders. (This was, no doubt, because the shareholders did not wish to be charged with surtax on them.) E In round figures they had made profits of £1,360,000, on which they had paid tax of £560,000, leaving a sum of £800,000 available for distribution as dividend net of tax. This was a dividend ripe to be stripped. The Gill family early in 1960 went to a firm of dealers in stocks and shares, called F.A. & A.B. Ltd. They specialised in dividend-stripping. They thought up a most ingenious scheme by which the dealers hoped to recover £400,000 of tax from the Revenue F and to split it between the Gill family and themselves. That is, £200,000 apiece. It was not possible early in 1960 to recover tax by means of "backward-stripping", such as was described in *Griffiths* v. *Harrison*[1] [1963] A.C. 1, because that had been stopped by s. 4 of the Finance (No. 2) Act 1955. So the dealers thought of doing it by means of "forward-stripping", such as was described in *Finsbury Securities Ltd.* v. *Bishop*[2] [1965] 1 W.L.R. 1206, G at page 1216. This was a loophole which was still available to dealers early in 1960. "Forward-stripping" was not banned until 5th April 1960, when it was caught by s. 28 of the Finance Act 1960. "Forward-stripping" meant that a company had to be found which would *in the future* make profits on which it could declare a dividend net of tax. The dealers would then buy the shares pregnant with future dividend, then later on the dealers would take H the dividend, sell the shares, show a loss, and recover the tax.

The plan was carried out in this way. A parent company was found, called Oakroyd Investments Ltd. The Gill family held all the shares in Oakroyd. Then an intermediate company was found called Elm Tree Industrial Finance Co. Ltd. Oakroyd held all the shares in Elm Tree, so the Gill family were, through Oakroyd, in control of Elm Tree. Elm Tree, in turn, held nearly all I the shares in the Spencer Wire Co. Ltd. So the Gill family were still in control of the Spencer group. The Spencer Wire Co. Ltd. declared a dividend of £800,000 net of tax. It was paid to Elm Tree. The result was that on 20th March 1960

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(1) 40 T.C. 281. (2) 43 T.C. 591.

(Lord Denning M.R.)

Elm Tree had in hand a sum of £800,000 net of tax (" grossed up " it was £1,360,000, less tax paid of £560,000, making £800,000 net of tax). On that date—20th March 1960—Oakroyd had no profits in hand from this venture, but it could confidently expect that in the future Elm Tree would declare a dividend of £800,000 net of tax. This was the future dividend to be stripped. By stripping it, the dealers hoped to get £400,000 out of the Revenue and divide it between the Gill family and themselves. Then these elaborate transactions took place, just before the Budget.

On 30th March 1960 the dealers bought from the Gill family all their shares in Oakroyd. The price was nearly £1,700,000. This price was arranged on the basis that Oakroyd would soon receive from Elm Tree a dividend of £800,000 net of tax. In addition Oakroyd had other investments worth nearly £700,000. Moreover, the dealers were in due course to pay the Gill family a sum of £200,000, being their share of the expected tax recovery. Thus these figures, £800,000, £700,000 and £200,000, made up the £1,700,000. The dealers paid the Gill family £1,500,000 in cash or its equivalent, and paid the £200,000 to stakeholders to await the tax recovery. A year later, on 30th March 1961, Elm Tree declared a dividend of £800,000 net of tax and paid it to Oakroyd: and Oakroyd in turn declared a dividend of £800,000 net of tax and paid it to the dealers (who were, of course, the owners of all the shares in Oakroyd). The dealers did not sell the shares in Oakroyd. They were advised not to do so, lest they fell foul of s. 28 of the Finance Act 1960. Afterwards the dealers made out their accounts for the year 1960–61. They of course omitted the dividend they had received, because share dealers are allowed by law to omit it. The upshot was:

	£
Cost of Oakroyd shares (March 1960)	1,700,000
Value of Oakroyd shares (March 1961)	700,000
Loss	1,000,000

Seeing that the accounts showed a loss of £1,000,000, the dealers prayed in aid of s. 341 of the Income Tax Act 1952. They claimed to recover the tax which had been paid on that sum, namely £400,000. If they were to succeed in getting £400,000 from the Revenue, the dealers were to ask the stakeholders to release the £200,000 to the Gill family. If they did not succeed in getting the £400,000 from the Revenue, the stakeholder was to return the £200,000 to the dealers. In short, if no part of the £400,000 was recovered, the dealers paid out £1,500,000 to the Gill family for the shares. If all the £400,000 was recovered, they would pay an extra £200,000 to the Gill family and keep £200,000 for themselves.

Such being the transaction, the question for us is whether it was an adventure " in the nature of trade " or merely a tax recovery device. The dealers say it is an adventure " in the nature of trade " because it is indistinguishable in essence from *Griffiths* v. *Harrison*(1) [1963] A.C. 1: whereas the Crown say it is a tax recovery device because it was on a par with the Mantern case in *Finsbury Securities Ltd.* v. *Bishop*(2) [1966] 1 W. L. R. 1402. The dealers point to various distinctions in their favour, such as that there was not here (as there was in the *Finsbury* case) any creation of special shares which carried special rights to dividends. The Crown point to other distinctions in their favour, such as that there was here an agreement to split the tax recovered between the dealers and the shareholders (as there was in the *Finsbury* case, but not in *Griffiths* v. *Harrison*). I do not propose to go into any such

(1) 40 T.C. 281. (2) 43 T.C. 591.

A distinctions. We should seek for the principle to be derived from the two cases in the House of Lords and not be led away into by-paths. And we should not place too much emphasis on a word here or there in the speeches. I agree with the way Megarry J. put it, [1968] 1 W.L.R. 1401, at page 1423(1). Put shortly, it comes to this: if the transaction is in truth a transaction in the nature of trade, it does not cease to be so simply because the trader had in mind B a tax advantage. But if it is in truth a tax-recovery device and nothing else, then it remains a tax-recovery device notwithstanding that it is clothed in the trappings of a trade. Applying this principle here, and looking at all the five transactions (as we are entitled to do), I am quite satisfied that these dealers—F.A. & A.B. Ltd.—were not, in any of these cases, carrying on a trade, or doing anything in the nature of a trade. Neither in the other four, nor in this one, C were they carrying on a trade. They were engaged, as the Commissioners found, in dividend-stripping transactions. I decline to elevate dividend-stripping into a trade. It is dividend-stripping and nothing else.

I find myself in agreement with the judgment of Megarry J., and I would dismiss this appeal.

Sachs L.J.—The Appellants, who at all material times were genuinely D trading as dealers in shares, on 30th March 1960 purchased all the 353,957 issued £1 shares (ordinary, deferred and preferred)—of which 99,702 had been issued and allotted that day—in Oakroyd Investments Ltd. The nature of the business of that company is indicated by its name. The contract under which the purchase was made involved payments to the extent of £1,678,932, including expenses. It was a dividend-stripping transaction in that the price for the shares E was largely dependent on the degree of ability to strip the dividends with which the shares were pregnant. After a dividend of £800,000 had been stripped on 31st March 1961, Oakroyd Investments Ltd. was still a going concern and its relevant shares remained in the hands of the Appellants backed by very substantial assets to the value of almost £700,000—quite a formidable figure. The Appellants had by then incurred a loss on the value of the shares of which F £800,000 was attributable to the dividend-strip. At the then current 7*s.* 9*d.* rate of income tax, the tax recovery on £800,000 would be £310,000. There had also been a further loss on the value of the shares, described in the relevant documents as "commercial loss", of £182,980. The tax which could be recovered on this further loss amounted to £70,907. The Appellants would then apparently have sold the shares but for doubts as to the effect of s. 28 of G the Finance Act 1960, which affected transactions after 5th April 1960—but not those of 30th March, six days earlier.

The transaction by which the Appellants acquired these 353,957 shares was in no way a sham, any more than would have been the sale of those shares backed by £700,000 of assets. The issue for this Court is whether so much of the loss on the value of the shares as was due to the stripping was a trade loss H within the meaning of the relevant words of s. 341(1) of the Income Tax Act 1952. Of that section it is to be noted that subs. (3) reads as follows:

> "For the purposes of this section, the amount of a loss sustained in a trade shall be computed in like manner as the profits or gains arising or accruing from the trade are computed under the provisions of this Act applicable to Case I of Schedule D."

I In calculating the loss no account can be taken of £800,000 received by way of dividend: *F.S. Securities Ltd.* v. *Commissioners of Inland Revenue* (2)[1965] A.C. 631.

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(1) *See* page 601 *ante*. (2) 41 T.C. 666.

(Sachs L.J.)

In *Harrison's* case[1] [1963] A.C. 1 the House of Lords, upholding a decision of this Court, held that a dividend-stripping transaction of 4th December 1953 resulted in a trade loss within the meaning of the same section. In that case the purchasing company had never before traded in shares; it had, to quote the phrase used by Lord Denning, at pages 17–18[2], " changed its way of life " by altering its memorandum of association to enable them so to trade; it had then on the above date for dividend-stripping purposes purchased for £16,900 all the shares in a company with a nominal capital of £1,000 that had ceased to carry on business but was pregnant with dividend moneys to the extent of £15,900—" it was simply a company pregnant with dividend ". The dividend was duly stripped on 26th January 1964, and the shares then on 24th June 1964 resold for £1,000. That was Harrison's only purchase of shares in the relevant financial year. The Commissioners had held that the transaction

> " was not entered into as part of any trade of dealing in shares and was not an adventure in the nature of trade. . . ."

But Lord Morris of Borth-y-Gest said, at page 23[3]:

> " . . . it seems to me that a trading transaction does not cease to be such merely because it is entered into in the confident hope that, under an existing state of the law, some fiscal advantage will result." And later, on page 24[4]: " The possibility of tax recovery may be a result made possible by the trading activity but I am unable to accept that if a transaction, fairly judged, has in reality and not fictitiously the features of an adventure in the nature of trade, it must be denied any such description if those taking part in it had their eyes fixed upon some fiscal advantage. My Lords, on the facts found in the present case I am driven to the conclusion that the transaction in the shares was entered into as part of a trade of dealing in shares or was an adventure in the nature of trade."

Lord Guest, at page 27[5], said:

> " In my view the transaction in question was an adventure in the nature of trade, and the Commissioners had no grounds upon which they could hold that it was not."

As against this decision the Crown relied on the *Finsbury Securities* case[6] [1966] 1 W.L.R. 1402, decided by the House of Lords on 28th June 1966, almost a year after the decision of the Commissioners in the instant case. In the *Finsbury* case the transactions considered related to the purchases of shares from some 15 different vendors by a company which had since its incorporation in 1956 carried on the trade of dealing in shares and securities. In twelve of these transactions (" the Warshaw type ") the company had acquired specially created 100 £1 6 per cent. preference shares with highly peculiar special rights. These shares were entitled to all the dividends paid for the next five years, absorbing the whole of the profits available for distribution, in addition to their fixed preference dividend. To these shares were attached no voting rights, and they were purchased for a sum which was to equal the total dividends to be distributed during those five years. The vendors retained all the ordinary shares and full control of the company. Substantial dividends were anticipated and paid: in the Warshaw case (entered into on 29th December 1958, and examined in detail in the speech of Lord Morris of Borth-y-Gest) they amounted to £60,000. Money successfully reclaimed from the Revenue by virtue of this dividend-stripping transaction was intended to be divided fifty-fifty as between the vendor and purchaser. At the end of the five years the 100 shares reverted to

(1) 40 T.C. 281. (2) *Ibid.*, at p. 297. (3) *Ibid.*, at p. 301. (4) *Ibid.*, at p. 302. (5) *Ibid.*, at p. 304. (6) 43 T.C. 591.

A being simple preference shares. In the end, the proceeds of the dividend-stripping having been divided, the preference shares would thus have at most the *de minimis* value of £100. Over the relevant period during which the stripping took place the purchasers did not even have the use of the moneys from which the dividends were paid. On the face of it the transaction consists *only*—and I emphasise the word " *only* "—of machinery for the recovery of tax and the B sharing by purchaser and vendor of such moneys as were successfully reclaimed from the Revenue. In truth there was no transaction in the nature of share-trading.

As regards the three other cases (" the Mantern type "), there is little about them in the report in [1966] 1 W.L.R. 1402. Mr. Monroe, however, pointed out that the relevant facts were to be found stated in the report in 43 T.C. 591; C in particular, he referred to page 594, where the Case is set out, and to pages 602-3, where Buckley J. considers this series. It was pressed on this Court that the Mantern type case could be distinguished from the Warshaw type case and showed an affinity with the one at present under consideration. The essence of the Mantern type case was that the vendor sold to the dealer for £100 all the shares in a company which owned a building lease and assets in the shape of D houses under construction. In addition to the £100, the dealer contracted to pay to the vendors 85 per cent. of the net profits made in the year ending 31st March 1960 by the sale of the assets of the company whose shares were thus sold. (By net profits was meant the gross profit after deduction of expenses but before deduction of income tax.) At the end of a relevant period (a year and eight days in the Mantern case itself) any assets not sold were to be E repurchased by the original vendors on an agreed basis. The result, of course, of the transaction would be that at the end of the relevant period (1st March 1960 in the Mantern case) the relevant shares would be, as Mr. Monroe conceded, a worthless shell. Moreover, during the relevant period whilst the shares had some assets behind them the Mantern directors were to remain, and did remain, in control, and there was no provision whatsoever for the F dealers having any share in that control. In effect, accordingly, the Mantern transaction was again one in which the parties simply embarked on a transaction which consisted *only* of machinery for recovering tax from the Revenue authorities and dividing the tax recovered amongst themselves and which also was designed to and did result in the shares involved becoming in substance worthless and unsaleable.

G In both cases the transaction was thus so devised that the shares transferred initially to the dealers gave the latter in essence no voice in the control of the relevant company, and indeed produced absolutely nothing more—if *de minimis* items are ignored—than the machinery to which I have already referred. The difference between the Mantern case and the Warshaw case was, in substance, only that in the latter the division was on a fifty-fifty basis and in H the former the dealers were to get 15 parts of the tax recovered whilst the vendors would receive 23·75 parts. It was in those circumstances that Lord Morris of Borth-y-Gest held that there was no transaction that could be properly described as trading in shares. " It was a wholly artificial device remote from trade to secure a tax advantage " : [1966] 1 W.L.R. 1402, at page 1418A(1). I will return to this phrase later. In the course of his speech—with which all the I other members of the House concurred—he made it clear that the *Harrison* case(2) remained in full force. Thus, at page 1416H(3), he said:

(1) 43 T.C. 591, at p. 627. (2) 40 T.C. 281. (3) 43 T.C., at p. 627A.

(Sachs L.J.)

> "It was my view in that case that the transaction was demonstrably a share-dealing transaction. Shares were bought; a dividend on them was received; later the shares were sold. There may be occasions when it is helpful to consider the object of a transaction when deciding as to its nature. In the *Harrison* case my view was that there could be no room for doubt as to the real and genuine nature of the transaction."

Then later, at page 1417H([1]), after stating that the submissions for the company depended mainly upon the argument that the shares were acquired as part of their stock-in-trade, he went on to say:

> "For the reasons I have already given, this transaction on its particular facts was not, within the definition of section 526, 'an adventure or concern in the nature of trade' at all. It was a wholly artificial device remote from trade to secure a tax advantage."

Previously he had referred to the element that in *Harrison's* case the vendors, after selling the shares, had no further concern in what happened, and I will discuss later whether that is of itself an element which without more affects the nature of the transaction.

I turn now to the judgment of Megarry J.]1968] 1 W.L.R. 1401. There is much in the judgment with which I respectfully agree, not least where he says that one must look at the transaction as a whole, and adds, at page 1422([2]):

> "So regarded, the question for me is whether these five transactions are on the *Harrison* side of the line or the *Finsbury*([3]) side."

But to my mind he did not adhere to that approach in relation to the instant case, and did not sufficiently examine the constituent elements of the transaction when deciding whether, looked at as a whole, it fell on one side of that line or the other. In any event, I would dissociate myself from the unnecessary criticism of certain submissions made by Counsel for the Company (see page 1420 G/H([4])). When the facts of an instant case can, as here, be submitted to be so much on one side of a line drawn by the House of Lords as to make it wrong for other Courts to say to the contrary, then Counsel is, of course, entitled to urge that only the House can take a contrary view. Whether that submission is on the instant facts right or wrong is beside the point: as will be seen later, I have found difficulty in rejecting it.

The facts of the *Harrison* case and of the instant case have perhaps already been sufficiently summarised in this judgment. None the less, it seems appropriate at this stage to compare certain aspects of them. (1) In the *Harrison* case the purchaser changed its face in order to enter into a single transaction in the relevant year: here the Appellants were established share dealers. (2) In the *Harrison* case the assets other than the dividend pregnancy can only have been worth £1,000 out of £16,900 (i.e., some 6 per cent. of the purchase price): here the assets other than the dividend pregnancy were at the date of the transaction apparently worth well over £800,000, i.e., more than the dividend later declared. (3) In the *Harrison* case the purchasing company was left with shares worth only £1,000—a relatively small unit for share-dealing stock-in-trade: in the instant case the purchasing company had, after the dividend was stripped, still in stock some 353,957 £1 shares backed by assets of nearly £700,000, that is to say, stock-in-trade of real value. (4) In both cases the purchasing companies obtained complete control of the company whose shares they purchased.

([1]) 43 T.C. 591, at p. 627H. ([2]) *See* page 600 *ante*. ([3]) 43 T.C. 591. ([4]) *See* page 599 *ante*.

A (5) In both cases they obtained control of the moneys later to be paid out in dividends—in *Harrison's* case[1] £15,900 and in the instant case £800,000. (6) In both cases the transactions would not have gone through upon the terms in fact reached but for the existence of the expectation of what Lord Morris described as a " fiscal advantage " by way of a tax recovery: but in the *Harrison* case it might well have been difficult for the above reasons to strike a share-
B dealing bargain at all if there had been no such expectation, whilst in the instant case there would *prima facie* have been no such difficulty.

So far the comparison of the salient features of the transactions in *Harrison's* case and the instant case quite clearly show that the latter not merely falls on the right side (from the Appellant's point of view) of the line, but a great deal further on that side than *Harrison's* case itself. Is it, however, brought
C over on to the wrong side of that line by the provision in clause 5(*d*)[2] which varies the price of the shares by an amount up to £200,000 according to the degree of success or otherwise of the tax recovery claim? That in essence is the £310,000 (or the £380,000) issue in this case: it is the issue on which the Crown founded its case. I accept Mr. Monroe's contention that this clause gave the vendors in an important sense a substantial interest in the recovery of tax and
D that it matters not in what form that interest is dressed up. I do not accept his calculation as to the percentage of that interest (a calculation which seemed based on speculation rather than evidence) as correct: but in the present case (having regard to the upper and lower brackets of the percentages under consideration) to my mind the exact percentage does not matter. It is clear that the clause also provided the purchasers with a considerable safeguard against
E two obvious risks. The first was that the imminent Finance Bill might retrospectively hit the transaction: the second was that the existing doubts as to whether the fiscal effect of such a transaction under the then current legislation might in the Courts be resolved adversely from the purchaser's point of view—a matter upon which there could be no certainty.

Mr. Monroe readily and rightly conceded that in this, as in many other
F types of transaction, purchasers are entitled to safeguard themselves against such risks and may do so by provisions which adjust the price to a purchaser by reference to how such risks may eventuate. It is a matter of bargaining as to the percentage of the risk which will be undertaken by purchaser and vendor respectively. Such bargains are nowadays regularly upheld and given effect to in relation to variations of trusts. If a vendor is paid the full ostensible value of
G the dividend (i.e., its amount after deduction of income tax) and the dealer is to get 100 per cent. of the tax recovery, the transaction falls on the right side of the line if there is a genuine dealing (*Harrison's* case). If the bargaining results in a firm price by which the dealer only gets in effect 50 per cent. of the tax recovery, does this change the nature of the transaction if the other criteria remain the same? To my mind the answer must be no. In what Mr. Monroe
H described as the " market in dividend-strippable shares ", no doubt the terms of the trade varied from time to time—and presumably hardened against sellers as Budget day approached. But so long as the transaction was a real dealing in shares the *Harrison* test must to my mind apply to the bargain as reached. The *Harrison* case recognised the market as having been a legitimate one.

If the dealer insures himself against the risks recited earlier in this
I judgment, does that then change the situation? There are passages in the speech of Lord Morris in the *Finsbury* case[3] which refer (see [1966] 1 W.L.R.

(1) 40 T.C. 281.
(2) Of the agreement for the purchase by F.A. & A.B. Ltd. of shares in Oakroyd Investments Ltd.
(3) 43 T.C. 591.

(Sachs L.J.)

1402, at page 1417[1]) to the retention by the vendor of an interest as providing a distinction from the *Harrison* case[2]) and as to that being " the essence of the arrangements ". But those passages should to my mind be read in the context of the facts of a transaction in which there was no other element than tax-recovery machinery. This seems implicit in the words " a *wholly* artificial device " already cited. So if the dealer insures himself against the risks above recited, this does not seem to me to affect the answer to the critical question.

Once the shares are shown to be bought by the dealer for resale, are and remain capable of resale at a substantial price, and there is nothing to prevent such a resale at any material time, *Harrison's* case governs the situation. In the instant case those factors are present: the shares could have been stripped and resold at once—another though not decisive distinction from the *Finsbury* case (see page 1417D [3])); the fact that the dealers were bound to do their best to effect a tax recovery did not preclude a sale—though later fears as to the effect of s. 28 of the Finance Act 1960 resulted in their being retained, a point which Mr. Monroe rightly conceded to be immaterial. The fact that a major, or indeed the major, attraction of an acquisition is dividend-stripping is shown by *Harrison's* case to be immaterial, providing there is a genuine trading: so is the fact that the transaction without the strip benefits would, on the expectations of the date it was entered into, not yield a profit and might result in a loss. A fiscal advantage being a proper object for bargaining in a trade deal, its value is for the parties. (Eliminating potential dividend-stripping benefits, the expectations in the instant case appear *prima facie* to have been substantially that there would be a break-even result—as in the *Harrison* case.) Shares backed by £700,000 or £800,000 of assets can by no stretch of imagination be regarded as unsaleable. Moreover, it may perhaps be asked why on 30th March 1960 should 99,702 further shares of £1 each have been issued and allotted unless as a part of or preliminary to a share-trading transaction—though some unknown fiscal advantage to shareholders may have been in contemplation.

For the Crown it was contended that on the facts the transaction was a mere tax-recovery device upon which was superimposed a dealing in shares. But again the *Harrison* case facts block the way. Neither the relative price paid for the dividend pregnancy element in a transaction nor the method of calculating that price (be it firm or variable) can of themselves without more alter the nature of a transaction which is otherwise on the right side of the line by being a genuine and substantial trading in shares. Just as Lord Morris felt himself " driven " to the conclusion he reached in the *Harrison* case, so do I feel myself constrained by the *ratio decidendi* in that case to negative the Crown's contentions. It thus seems to me that the £200,000 clause, on which alone reliance was placed by the Crown (all other points were merely ancillary), cannot bring the transaction over on to the wrong side of the line—it remains firmly on the right side as a trading transaction in which there is a strong element of potential fiscal advantage, and I would allow the appeal.

I should perhaps add references to three points. Firstly, that before Megarry J. it was accepted (see [1968] 1 W.L.R. 1401, at page 1413[4]) by both parties that the question for the Court is one of law, and it was so argued here. Moreover, in *Harrison's* case the Commissioners' ostensible findings of fact were reversed, as also happened in the *Finsbury* case: so I have not examined in detail the findings of the Commissioners in the instant case—more especially as they had perforce to be reached without the assistance of the House of Lords'

(1) 43 T.C. 591, at p. 627. (2) 40 T.C. 281. (3) 43 T.C., at p. 627.
(4) *See* page 593 *ante*.

A decision in the *Finsbury* case [1], and thus without having in mind the criteria which affected that decision. Secondly, there is to my mind simply no evidence upon which it can properly be inferred that the £182,980 " commercial loss " was other than it purported to be. It is to be noted that the use over the relevant period of assets totalling over £1,500,000 (i.e., including the £800,000 used for dividends) can well result in a loss or a profit of that order: that would depend B on the management of the funds. Thirdly, it is to be noted that from first to last the Crown's case was that the relevant transaction was not a trading transaction at all. At no stage was it suggested that if, contrary to that contention, it were such a transaction then part (£310,000) of the year's loss could be severed and treated none the less as not being a trade loss. I have assumed the Crown had good reasons for not making any such admission—stemming C no doubt from the *ratio decidendi* of the *Harrison* case[2], which Mr. Monroe, of course, unreservedly accepted as good law. Be that as it may, such point not having been taken before the Commissioners, Megarry J. or this Court, it can hardly now remain open to the Crown.

Whatever may be the correct view of the ethics of dividend-stripping transactions—and they have no attraction for me in the shape with which this D Court is now concerned—it is clear from *Harrison's* case that there are many sets of facts which can bring a dividend-stripping transaction within the ambit of s. 341 of the Income Tax Act 1952. Not only has this been decided in *Harrison's* case, but it is to be noted that s. 4 of the Finance (No. 2) Act 1955 only sought to exclude from the ambit of s. 341 a limited category of such transactions, and that that was a category into which the instant transaction does not fall. The E absence of reference to forward-stripping, for instance, cannot have been unintentional unless one assumes a degree of lack of knowledge and prescience which one cannot rightly attribute to those concerned with such fiscal measures. If the Legislature chooses to leave a category of dividend-stripping untouched by a Finance Act, it does not seem to me that it is for the Courts to interfere.

Phillimore L.J.—Megarry J. had to consider five transactions into which F F.A. & A.B. Ltd., a company engaged in share-dealing, had entered in the year 1959-60. He held that each of these five transactions was dividend-stripping, i.e., that in each case the transaction was in no way characteristic of and did not possess the ordinary features of the trade of share-dealing, but represented " a wholly artificial device remote from trade and designed to secure a tax advantage ", to use the words of Lord Morris in *Finsbury* G *Securities Ltd.* v. *Bishop* [1966] 1 W.L.R. 1402. He therefore found for the Crown. F.A. & A.B. Ltd. do not seek to argue that the decision of Megarry J. was wrong in four out of the five cases, but in the fifth—that involving Oakroyd Investments Ltd.—they have argued the appeal.

Where, as here, the arguments of Counsel on both sides are of the highest quality, the mind of a Judge inexperienced in a very specialist field tends to H waver, but I have finally come to the same conclusion as Lord Denning M.R. I think Megarry J. was clearly right, and I would dismiss this appeal.

At the date of this transaction at the end of March 1960 backward-stripping had been stopped by s. 4 of the Finance (No. 2) Act 1955. A few days later, and this deal, which involved forward-stripping, would have fallen foul of s. 28 of the Finance Act 1960. The essence of this transaction was that I F.A. & A.B.'s chances of a substantial profit really depended on recovering £400,000 from the Revenue and that they and the vendors were to share the benefit of the £400,000 as and when this sum was obtained. Thus both vendors and purchasers were looking to the tax advantage and the whole deal was geared to this.

(1) 43 T.C. 591. (2) 40 T.C. 281.

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Since the issue turns entirely upon the facts, I hope I may be forgiven for restating them in my own way. The background to this transaction, by which F.A. & A.B. Ltd. bought all the shares in Oakroyd Investments Ltd. from the members of the Gill family who owned them, was as follows. Oakroyd Investments Ltd. had three wholly-owned subsidiaries, Spencers of Wakefield Ltd., Spencers Equipment Ltd. and Elm Tree Industrial Finance Co. Ltd. These subsidiaries were of little importance in themselves, but Elm Tree owned all but a very small number of the shares in the Spencer Wire Co. Ltd., a company which was actively trading as a manufacturer processing and smelting copper. It seems clear that it was this company which was the real money-spinner on which the group depended. It looks as if the first step involved the sale by Spencer Wire of its manufacturing capacity for cash, and accordingly that company sold its properties and trading assets for £725,206. It was suggested by Counsel for the Crown that the probable inference from passages at pages 88, 90 and 91 of the bundle is that this sale was in fact to the members of the Gill family; but this, albeit not unlikely, must remain speculative. Presumably at about this stage F.A. & A.B. Ltd. bought the small quantity of shares in Spencer Wire not already owned by Elm Tree (see page 28). Everything was now ready for the operation which was carried out at great speed to anticipate the Budget. By an agreement said to be made on 25th March 1960, but which cannot in fact have been concluded before the 30th (see clause 5(*b*) at page 84), the members of the Gill family sold all the shares in Oakroyd Investments Ltd. to F.A. & A.B. Ltd. for £1,323,946 together with such sum as would equal the excess of the book debts of Spencer Wire over its liabilities—this proved to be £336,000, so that the total price was £1,659,946. The transaction was to be completed on the following day, and by clause 5(*d*) the vendors warranted that Elm Tree was in a position to declare a net dividend of £800,000 (presumably Spencer Wire had already declared a dividend of this amount); it was also agreed that F.A. & A.B. Ltd. were to be entitled to recover tax on any reduction in the value of the shares in Oakroyd, and that if they failed to do so the vendors would pay them by way of liquidated damages the difference, if any, between half the tax recovered and £200,000. By a parallel agreement, to which the Anglo-Israel Bank were also parties, the bank was to hold £200,000 of the money paid by F.A. & A.B. Ltd. pending the outcome of the anticipated claim by the purchasers to recover tax which was anticipated to produce £400,000 or a little less. If that claim succeeded, the vendors got the £200,000 or, in effect, half the tax recovered. If it failed, the £200,000 was to be paid to F.A. & A.B. Ltd. as liquidated damages—in other words, the purchase price was reducible by that amount. In the event, after a decent interval of one year, so that the strip should be a forward one, Elm Tree duly declared the dividend of £800,000 net, which passed to Oakroyd and thence under the provisions of the agreement to F.A. & A.B. Ltd., who proceeded to claim to recover £400,000 tax in view of the reduced value of the shares.

What then was the position? F.A. & A.B. Ltd. had paid £1,659,946 for the shares in Oakroyd, of which £200,000 was held by the bank pending the claim to recover tax. They had also paid a few thousand pounds for the shares in Spencer Wire not owned by Elm Tree. In return for what they had paid, F.A. & A.B. Ltd. had received the dividend of £800,000 and other assets to the value of £695,952, which no doubt were largely derived from the sale by Spencer Wire of its manufacturing capacity. Thus F.A. & A.B. Ltd. had received £1,495,952, and if their claim to tax failed they would be repaid the £200,000 held by the bank. If, on the other hand, the claim succeeded, the bank would pay the £200,000 to the vendors, who would thus have received the full £1,659,946, and F.A. & A.B. Ltd. would add the £400,000 recovered from the

(Phillimore L.J.)

A Revenue to the £1,495,952 they had already derived from the sale. In other words, if the tax claim failed, they made a profit of a few thousands at most, but if it succeeded the profit was about £200,000. Equally, the vendors depended on the success of the claim for £200,000 of the agreed price. They had, of course, in addition the inestimable advantage of acquiring tax-free capital in place of dividends on which they would have paid thousands in surtax.

B Alas, the Crown refused to pay the claim by F.A. & A.B. Ltd. to recover the tax, and it is I think clear that the Special Commissioners would have upheld the Crown but for the decision of the House of Lords in *Griffiths* v. *Harrison*(1) [1963] A.C. 1. At the time the matter was before them *Finsbury Securities Ltd.* v. *Bishop*(2) had not been decided. In truth, the *Harrison* case was totally different from the facts here. True the purchaser there bought in order to strip, C but there is nothing to suggest that the vendor knew of this intention or stood to derive any benefit from the strip. So far as he was concerned, there was nothing to show that this was not a normal deal in shares. Here the whole transaction was geared to the strip and the tax claim, from which both parties stood to profit equally. The only reason for this deal was fiscal advantage as opposed to normal trade. In my view it is highly improbable that either party would have D entered into this transaction on any other basis. In my judgment the case is covered by the decision in *Finsbury Securities Ltd.* v. *Bishop*, and especially in relation to the Mantern transactions—one of those considered in that case, details of which are to be found in 43 T.C. 591.

I would dismiss this appeal.

Phillips Q.C.—Would your Lordships say, with costs?

E **Lord Denning M.R.**—Yes, appeal dismissed with costs.

Nolan Q.C.—My Lord, may my clients have leave to appeal to their Lordships now in this matter?

Lord Denning M.R.—Well, the whole thing is in a way resolved by the Legislature; but I suppose it is the amount involved?

Nolan Q.C.—The amount involved is substantial, and, of course, there are F other cases which have come before the Court.

Lord Denning M.R.—What do you say, Mr. Phillips?

Phillips Q.C.—My Lord, the Crown does not make any observations one way or the other.

(*The Court conferred.*)

Lord Denning M.R.—You shall have your leave.

G **Nolan Q.C.**—I am much obliged, my Lord.

The Company having appealed against the above decision, the case came before the House of Lords (Lords Morris of Borth-y-Gest and Guest, Viscount Dilhorne and Lords Donovan and Simon of Glaisdale) on 21st, 22nd, 23rd and H 24th June 1971, when judgment was reserved. On 21st October 1971 judgment was given unanimously in favour of the Crown, with costs.

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(1) 40 T.C. 281. (2) 43 T.C. 591.

(1)*S. W. Templeman Q.C.*, *Michael Nolan Q.C.* and *Stephen Oliver* for the Company. This appeal is concerned with the distinction, for the purposes of income tax, between a trading transaction and a tax recovery device. The Appellant Company was engaged in trading transactions as a dealer in stocks and shares in the relevant years of assessment. One transaction of this nature was the purchase by the Appellant on 30th March 1960 (that is, in the tax year 1959–60) of the share capital of Oakroyd Investments Ltd., and this purchase resulted in a loss in the following year 1960–61. The relevant statutory provisions are ss. 341 and 526 of the Income Tax Act 1952. The question is: has the Appellant Company suffered a loss in respect of its trade as a dealer in shares and other investments?

It is well recognised that, when the shares of a company which has a large profit reserve are bought, that factor is reflected in the price paid by the purchaser. When the profit is paid out in the form of dividend the value of the shares goes down, and for the purpose of calculating the loss incurred where the buyer is a dealer one looks at the difference between the price which he paid for the shares and their ultimate value after the dividend has been paid, but the dividend he has received is not added in, it is ignored: *F. S. Securities Ltd.* v. *Commissioners of Inland Revenue* 41 T.C. 666; [1965] A.C. 631. The odd feature about *F. S. Securities* was that it was the Crown that successfully put forward the argument that the dividend is ignored when calculating the profit of the trader who is dealing in the shares, and it was put forward because if the dividend was ignored the profit was not trading income but investment income and the shareholders in the company could then be assessed on it to surtax. The logic of that decision is that a trader in shares can for tax purposes show a loss when in fact he is not a penny the worse off, and the loss he shows is the amount of dividend he has received. He can therefore claim tax on that dividend under s. 341 and he gets back the tax which has been paid, and rightly paid, by someone else.

The present case is indistinguishable from the decision of this House in *J. P. Harrison* (*Watford*) *Ltd.* v. *Griffiths* 40 T.C. 281; [1963] A.C. 1. The ratio of the majority was that a transaction whereby a dealer in shares acquires shares for the purpose of obtaining control of the company, stripping a dividend, claiming the tax thereon and reselling, is a trading transaction. Its relevance to the present case is that a transaction of that nature does not cease to be a trading transaction because the price paid by the dealer will, in the event of tax being recovered, reflect the special value of the shares to the dealer. As to cases concerning a tax recovery device, the material case is the decision of this House in *Finsbury Securities Ltd.* v. *Bishop* 43 T.C. 591; [1966] 1 W.L.R. 1402. The transactions in *Finsbury* fell into two categories, the Warshaw transaction and the Mantern transaction, both of which were clearly tax recovery devices. In that case *Harrison* was distinguished on grounds which apply *mutatis mutandis* to the present case, for the only difference between the present case and *Harrison* is that in *Harrison* the dealer bought the shares at a price which was that at which a non-dealer would buy. Here the dealer bought the shares for £200,000 more than their value, and that sum was to be paid back if he made exactly the same tax loss and repayment claim as was the subject of *Harrison*. In other words, if he makes and retains all the tax loss, as in *Harrison*, it is trading, and it remains trading if the dealer makes and retains all the tax loss but adjusts the price. It is emphasised that *Finsbury* is a wholly different case from the present and *Harrison*. The fact that there was in the present case an obligation to the vendor is not a material distinction between this case and *Harrison*. All that it entails is that in the present case there was a more

(1) Argument reported by J. A. Griffiths Esq., Barrister-at-Law.

A sophisticated vendor than in *Harrison*[1], for here the vendor realised that the shares were worth more to F.A. & A.B. than they would be to the majority of potential purchasers thereof.

The vital distinction between *Finsbury*[2] on the one hand and *Harrison* and *F.A. & A.B.* on the other is that in *Finsbury* all that was obtained was a mere right to claim on the Revenue, whilst in *Harrison* and the present case B what was obtained, for better or worse, was control of the company, the whole of the issued share capital of the company.

The judgment of Megarry J. is open to criticism in that it does not analyse the difference between what was bought in this case and what was bought in *Finsbury*. In the Court of Appeal reliance is placed on the dissenting judgment of Sachs L.J., which was approved of in *Thomson* v. *Gurneville* C *Securities Ltd.* page 633 *post;* [1970] 1 W.L.R. 477.

It may be that a trading transaction is difficult or impossible to define so as to cover every conceivable case, but there are certain *indicia* which label a trading transaction. First, the purchaser must buy shares with the intention of reselling. Secondly, by buying the shares he must become entitled to the dividends. Thirdly, he must become entitled to the same rights as the former D shareholders. Fourthly, if he is buying controlling shares he must be acquiring assets which can be dealt with; he must have the control which those shares confer. If those four conditions are satisfied then there is a trading transaction. In the present case the transaction carried out by the Appellant Company satisfies those conditions. In contradistinction, in the *Finsbury* case 43 T.C. 591 the shares were not bought with the intention of reselling, because all that E would remain at the end of the Warshaw type of case was the £100 preference shares and the 6 per cent. coupon and it cannot be validly argued that the intention was to buy and resell those. Secondly, in *Finsbury* the purchaser did not become entitled to the dividends. He did in one respect, in that they were paid to him in the first instance, but they were all passed on as and when they were received in the form of purchase price. Thirdly, in *Finsbury*, in the Mantern F type of case, where there was not the creation of special preference shares but the sale of ordinary shares, the purchasers did not become entitled to the same rights as the former shareholders; it was the vendor of the shares who remained in control of the company throughout and who continued to carry on as though there had never been a sale. Equally, of course, in the *Finsbury* type of transaction the purchaser does not acquire the assets of the company.

G The difference between the cases may be summarised as follows. In *Finsbury* the vendors continued their activities just as though they had never sold the shares. In the present case, as in *Harrison* 40 T.C. 281, the vendors dropped out of the picture so far as the shares and so far as the company and its management and operation were concerned. The vendors remain interested, not in the company's trading or in the shares, but in the purchasers' stripping H a dividend and making a claim against the Revenue. They do not retain an interest in the shares. Accordingly, in the present case, as in *Harrison*, the purchasers acquired shares in which they intended to deal, whilst in *Finsbury* what the dealer acquired was merely pieces of paper which enabled him to make a tax claim.

Finally, to the contention that F.A. & A.B. were not trading because I the object of the transaction was to obtain a fiscal advantage the answer is twofold. First, shortly and simply, the decision in *Harrison*. Secondly, the question of object or motive is a very dangerous criterion, especially when applied to Revenue cases. The courts should not change a trading transaction into a non-trading transaction because of the motive: see *Duke of Westminster*

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(1) 40 T.C. 281. (2) 43 T.C. 591.

v. *Commissioners of Inland Revenue* 19 T.C. 490; [1936] A.C. 1, where this House expelled the heresy of motive. A

H. H. Monroe Q.C., *Patrick Medd* and *J. P. Warner* for the Crown. The sale agreement provides machinery for a formula for dividing up the tax to be recovered, if any, between vendor and purchaser. This is a more realistic description of the agreement than that given by the Appellant.

B The question for determination is: it not being in doubt that F.A. & A.B. were trading as dealers, did the Appellant Company buy the O.I. shares as stock-in-trade for the purposes of that trade? Were they trading as dealers when they bought the shares? For it is the treatment of the shares as stock which enables the favourable tax consequences to arise. *J. P. Harrison (Watford) Ltd.* v. *Griffiths*[1] is authority for the proposition that, where one has a dealer purchasing shares as stock in circumstances where beyond doubt it is C a purchase of stock-in-trade, then the mere fact that the dealer's eye was fixed on tax recovery cannot alter the nature of the transaction as one of trade. The question of motive or purpose arises at the outset. Is the transaction in question a trading transaction? The test is solely an objective test.

Clause 9(*b*)[2] of the sale agreement points to the fact that the present case falls within *Finsbury Securities Ltd.* v. *Bishop* 43 T.C. 591 and not within D *Harrison.* This transaction, properly understood, owed all its distinctive features to the fact that its object was the recovery of tax. It was not the purchase of shares as stock but money laid out as part of a tax recovery scheme. The £200,000 was advance payment for the recovery of tax, and if the scheme was unsuccessful then this sum was to be repaid. It is essential to realise here that there was a dividend to be stripped and that the transaction did not come E within s. 4 of the Finance (No. 2) Act 1955. This is another indication that this was not a purchase of stock-in-trade but was a tax extraction scheme.

Where the only profit sought comes from the tax recovery scheme it is not a dealer's profit, because it is not a dealer's transaction.

The following are the Crown's submissions on the three possible views of the *Harrison* case 40 T.C. 281. F

(1) On the basis that the Appellant's contention of what is the ratio of *Harrison* is correct, the House should depart from that decision to the extent of holding that a transaction whose sole or main purpose is to secure a repayment of income tax is not within the ambit of the word " trade " in the Income Tax Act 1952: see *per* Lord Reid in *Harrison* 40 T.C. 281, 295, who points out that expense incurred in seeking to recover tax from the Revenue is not a G trading expense.

(2) The ratio of *Harrison* is that a trading transaction is not the less a trading transaction if undertaken with a view of effecting a tax recovery. On that view, the critical question here is: was it a trading transaction at all? The question *quo animo* comes in at this critical stage when one makes the inquiry concerning the purpose for which the shares were acquired. In the H present case the transaction never was a trading transaction but was merely machinery for recovering tax.

(3) The present transaction is akin to *Finsbury* 43 T.C. 591 and not to *Harrison* in that the contract between the parties tied the vendor into the activities of the purchaser after the sale in the sense that the outcome of the transaction from the vendor's point of view to some extent depended on what was done I by the purchaser after the sale. That is a feature of a tax recovery transaction rather than a trading transaction.

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[1] 40 T.C. 281. [2] *See* page 622 *post*.

A In fine, whatever a dealing in shares may cover, the present operation was not a dealing in shares by way of trade but a transaction which was a key to unlocking the door of the Treasury.

Templeman Q.C. replied.

Lord Morris of Borth-y-Gest—My Lords, this is one more case in which B the question which arose for consideration was whether certain transactions should fairly and reasonably be regarded as share-dealing transactions resulting in the acquisition of shares by a company as a dealer in shares so that they became part of its stock-in-trade or whether the transactions could not fairly and reasonably be so regarded.

At all relevant times the Appellant Company was trading as a dealer in C stocks and shares. It entered into numerous transactions in stocks and shares. The proceedings which culminate in your Lordships' House related only to five transactions. It does not follow that because a person is carrying on a trade as a dealer in shares every transaction into which he enters will be a dealing in shares in the course of his trade. So the question arose in regard to five particular transactions. The way that the question arose was that there was D an assessment to income tax made upon the Company for the year 1960–61. The Company appealed and claimed relief from tax under s. 341 of the Income Tax Act 1952 for the years 1959–60, 1960–61 and 1961–62 in respect of losses claimed by the Company to have been sustained by it in those years in its trade as a dealer in stocks and shares. In the Case Stated the Special Commissioners carefully summarised the five transactions (which were in relation to shares in E five separate companies) which were entered into by the Appellant Company. The Commissioners had in mind the decision in *J. P. Harrison (Watford) Ltd.* v. *Griffiths*[1] [1963] A.C. 1 and the decision of the Court of Appeal on 7th July 1965 in *Finsbury Securities Ltd.* v. *Bishop*[2] (which was later reversed in this House). They found that the five transactions, which they described as " dividend-stripping transactions ", had formed part of the trade of the Company of F dealing in shares. Megarry J. reversed the decision of the Special Commissioners. Though with some hesitation in regard to one of the five transactions, he held in the case of all of them that they were not trading transactions in the course of the Company's trade: rather were they to be regarded as artificial devices remote from trade in order to secure tax advantages. The Appellants did not appeal against the decision of the learned Judge in regard to four of the G five transactions. Their appeal in relation to the fifth was dismissed by the Court of Appeal (Lord Denning M.R. and Phillimore L.J., Sachs L.J. dissenting).

So it becomes necessary carefully to examine this fifth transaction. Ought it, when viewed fairly and rationally, to be classed as a trading transaction coming within the trade of a dealer in shares? Ultimately this becomes a matter of judgment. In such cases as these some help may be derived from H considering the decisions of courts as to how other transactions have been regarded. One transaction with certain features may have been held to have been a transaction properly to be regarded as being within the trade of a dealer in shares. Another transaction with other features may have been held not to have been one which could properly be so regarded. Deriving such help as a consideration of other cases may yield, the question for decision will be I whether the particular transaction under review can and should be regarded as a trading transaction within the course of the trade of a dealer in shares.

This enquiry may or may not involve or necessitate a consideration of the profitability of a transaction or of the tax results of a transaction. One trading

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(1) 40 T.C. 281. (2) 43 T.C. 591; [1965] 1 W.L.R. 1206 (C.A.); [1966] 1 W.L.R. 1402 (H.L.).

(Lord Morris of Borth-y-Gest)

transaction may result in a profit. Another may result in a loss. If each of these, fairly judged, is undoubtedly a trading transaction its nature is not altered according to whether from a financial point of view it works out favourably or unfavourably. Nor is such a transaction altered in its nature according to how the revenue laws determine the tax position which results from the financial position. The opening words of s. 341 of the Income Tax Act 1952 are as follows: " Where any person sustains a loss in any trade, profession, employment or vocation ". If an application for an adjustment of liability is made in regard to an alleged loss in a trade the first enquiry will be whether the transaction alleged to have resulted in a loss was ever a transaction in the particular trade at all. Only if it was would it be necessary to consider whether or not a loss had resulted. A B

If, before changes in the law were made, a dealer unversed in revenue law had bought shares, pregnant with dividend, of a company that had paid tax on its profits, he might have resold the shares and made a profit or he might have received a dividend and then sold the shares and made about the same profit. But there could have been different consequences according to which course he followed. If he had received a dividend and then sold the shares and if (being unversed in revenue law) he had told his advisers that he had made a trading profit he would, greatly to his surprise, have been told that, though he had more in his pocket at the end of his transaction than at its start, he would for purposes of revenue law have made a loss. He would have been told that because of the dividend payment his shares had declined in value to the extent of that payment, with the result that he had made a loss in his trade in the calculation of which he could omit the amount of the dividend payment that he had received and that actually he might be able to make a claim for recovery of tax: so that as an after-effect of his transaction the revenue laws would yield a large benefit to him if he wished to take it and thought it right to take it. He might contemplate that the revenue laws would be changed, but he might ask whether if he made another precisely similar transaction, but this time with knowledge of the revenue laws, the result would be any different. In my view, he would have been told that if he made a similar ordinary trading transaction its nature would not change according to whether he knew or did not know what under revenue law would be or could be the possible fiscal results for him. Many people order their affairs either with or without expert guidance in such ways as, on a correct application of the law, will prove most to their benefit. C D E F

As a result of the above-noted feature of revenue law and of various other features there have emerged in recent periods certain hybrid transactions. These are paraded by their admirers as possessing the guise and the garb of trading transactions. Others think of the analogy of a wolf in sheep's clothing with the Revenue as the prey. It may be that there are some who have become specialists in the devising of such transactions and who as a result are sought out by and are consulted by vendors of shares who seek to have part of the profit for which such transactions provide. If any of these specialists are to be found amongst those whose ordinary trade is that of dealing in shares it must be said that in the fashioning of these tax-engineering operations they may be stepping aside from the paths of their trade. The question in any particular case may be whether they have so stepped aside. G H

Some submissions were made by Mr. Monroe in regard to the decision in your Lordships' House in *J. P. Harrison (Watford) Ltd.* v. *Griffiths*(1). In that case a purchase of shares was made by a dealer in shares. After a dividend had I

(1) 40 T.C. 281.

A been declared the shares were sold. The dealer in the result made a small profit. The seller of the shares had no interest in them once he had been paid. He was thereafter in no way concerned. It did not matter to him what the purchasers did with the shares. In fact the purchasers had knowledge of the revenue laws as they then stood and had had it in mind to invoke the operation of those laws. They proposed to make a claim under s. 341 by asserting that, as the shares B which they had bought became diminished in value as a result of the declaration of dividend, they had suffered a loss to the extent of that diminution. In computing that loss they could ignore the payment they had actually received by way of dividend. Whether they chose to make a claim under s. 341 and assert that they had sustained a loss in trade was entirely their affair. The vendors of the shares would neither gain nor lose according to whether or C not a claim was made. The question then arises whether a trading transaction which is entered into with a view to the obtaining subsequently of such benefit as may or could result from the application of revenue law will cease to be such a trading transaction or will never have been such a transaction once the motive which inspired it is known. In the *Harrison* case[1] the decision (by a majority) of your Lordships' House, affirming the majority decision of the Court of Appeal, D which affirmed the decision of the learned Judge, was that trading transactions do not cease to be trading transactions merely because they are entered into in the hope of later taking advantage of the revenue law by making a claim for recovery of tax. The making of such a claim would not be a part of any trading transaction and would not itself be a trading transaction. The approach of Mr. Monroe was as follows. He submitted that, if there is a trading transaction, the E fact that the motive which inspired it was that fiscal benefit might be made to result does not transform the trading transaction into something else. To that extent Mr. Monroe accepted and supported the principle which guided decision in *Harrison's* case. Stated otherwise, Mr. Monroe submitted that if there is a transaction which is unambiguously a trading transaction the circumstance that a tax benefit is in view does not alter the fact that the transaction is and remains F a trading transaction. The motive which inspires a transaction must of course exist before the transaction. It follows that the presence or absence of a motive of securing a tax benefit is irrelevant when deciding whether a transaction is or is not a trading transaction. In spite of this, it was contended that the transaction in *Harrison's* case was not a trading transaction. When the reason for this contention was advanced it lay only in the circumstance that the motive G that inspired the transaction was that of later securing a tax benefit. But, my Lords, once it is accepted, as it must be, that motive does not and cannot alter or transform the essential and factual nature of a transaction, it must follow that it is the transaction itself and its form and content which is to be examined and considered. If the motive or hope of later obtaining a tax benefit is left out of account, the purchase of shares by a dealer in shares and their later sale H must unambiguously be classed as a trading transaction.

The transactions in the *Harrison* case were solely and unambiguously trading transactions. There was a purchase of shares and after receipt of a dividend a sale of shares. There was no term, express or implied, in any contract or any transaction which in any way introduced any fiscal element. No fiscal consideration or arrangement intruded itself in any way into any bargain that I was made. There was merely an acknowledged reason which inspired one party to enter into certain trading transactions. If that party later made some tax claim that claim would be no part of a trading activity. The transactions in the *Harrison* case not only had all the characteristics of trading: there was

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(1) 40 T.C. 281.

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no characteristic which was not trading. There was nothing equivocal. There was no problem to be solved as to what acts were done. To the question *quid actum est* there could be but one answer. The question *quo animo* was irrelevant. As Lord Reid said in giving the judgment of the Board in *Iswera* v. *Commissioner of Inland Revenue* [1965] 1 W.L.R. 663 (P.C.) (at page 668):

> " If, in order to get what he wants, the taxpayer has to embark on an adventure which has all the characteristics of trading, his purpose or object alone cannot prevail over what he in fact does. But if his acts are equivocal his purpose or object may be a very material factor when weighing the total effects of all the circumstances."

The somewhat loose phrase " dividend-stripping transaction " has acquired a certain emotive force, but if it is used its meaning must be examined. It has been suggested that the *Harrison* case[1] decided that a transaction can be a trading transaction even though it is a pure dividend-stripping transaction entered into with the sole object of making a fiscal profit without any view to a commercial profit. Analysis will show that such a suggestion is ill-founded and misleading. The word " transaction " generally suggests some arrangement between two or more persons. In the *Harrison* case there was a purchase of shares from a seller of them. That was a trading transaction. Later there was a sale of the shares to a new purchaser. That was a trading transaction. In between there had been the declaration and receipt of a dividend. But there was no arrangement whatsoever under which the sellers to Harrisons of the shares or the purchasers from them of the shares were concerned as to whether Harrisons would or would not later make some claim which under the law as it then stood they might be able to make. There was, therefore, no dividend-stripping " transaction " in the *Harrison* case in the sense that any other person had any control or concern or interest as to what Harrisons would do once they had bought the shares. If, therefore, as in my view is clear, the presence of a motive of securing tax recovery does not cause a trading transaction to cease to be one, then reliance on motive must disappear. And if reliance on motive is either voluntarily or reluctantly but compulsively jettisoned it is not saved even if the language of rhetoric is used to characterise it.

It is manifest that some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction. The result will be, not that a trading transaction with unusual features is revealed, but that there is an arrangement or scheme which cannot fairly be regarded as being a transaction in the trade of dealing in shares. The transactions which were under review in *Finsbury Securities Ltd.* v. *Bishop*[2] [1966] 1 W.L.R. 1402 were of this nature. The transactions have only to be looked at for it to be seen that they were wholly and fundamentally different from the transactions in the *Harrison* case. Whereas in the *Harrison* case there is not a trace of any fiscal " arrangement ", in the *Finsbury* case certain fiscal arrangements were inherently and structurally a part of the transactions which it was sought to describe as trading transactions. The *Harrison* case and the *Finsbury* case are wholly different from each other. In the *Harrison* case the transactions contained no fiscal arrangements whatsoever: in the *Finsbury* case such arrangements were central to and pivotal of the transactions under review.

There are, therefore, cases where, as Megarry J. indicated, the fiscal element has so invaded the transaction itself that it is moulded and shaped by the fiscal elements. This was helpfully expressed by Megarry J. as follows[3]:

(1) 40 T. C. 281. (2) 43 T.C. 591. (3) *See* page 598 *ante*.

A " If upon analysis it is found that the greater part of the transaction consists of elements for which there is some trading purpose or explanation (whether ordinary or extraordinary), then the presence of what I may call ' fiscal elements ', inserted solely or mainly for the purpose of producing a fiscal benefit, may not suffice to deprive the transaction of its trading status. The question is whether, viewed as a whole, the transaction is B one which can fairly be regarded as a trading transaction. If it is, then it will not be denatured merely because it was entered into with motives of reaping a fiscal advantage. Neither fiscal elements nor fiscal motives will prevent what in substance is a trading transaction from ranking as such. On the other hand, if the greater part of the transaction is explicable only on fiscal grounds, the mere presence of elements of trading will not suffice C to translate the transaction into the realms of trading. In particular, if what is erected is predominantly an artificial structure, remote from trading and fashioned so as to secure a tax advantage, the mere presence in that structure of certain elements which by themselves could fairly be described as trading will not cast the cloak of trade over the whole structure."

D The transaction now under review was dated 30th March 1960. It was an agreement relating to the shares in a company called Oakroyd Investments Ltd. (" O.I. Ltd."). That company (an investment company) was the parent company of a group of companies carrying on business as copper processors and smelters. A company called Elm Tree Industrial Finance Co. Ltd. (" Elm Tree ") was a wholly-owned subsidiary of O.I. Ltd. A company called Spencer E Wire Co. Ltd. (" Spencer ") was a subsidiary of Elm Tree. The shares in O.I. Ltd. were held by members of a family (the Gill family). The shares were of great value because good profits had been made in the business. Elm Tree had in hand a sum of £800,000 net of tax. Elm Tree had paid tax of £506,000. Elm Tree would be in a position to pay a dividend to O.I. Ltd. The dividend could be one of £800,000 net. The Gill family then entered into an agreement F (on 30th March 1960) with the Appellants for the sale of their shares in O.I. Ltd. It is not necessary to set out all the provisions contained in its nine clauses. It is beyond question that the provisions were such that the price to be received by the Gill family was to be dependent upon the success or failure of a tax-recovery claim which the Appellants undertook to make. It is apparent, therefore, that the transaction was not one in which any possible tax consequences G resulting to a purchaser of shares would be his concern and would be no concern of the seller of the shares, but it was one in which there was a carefully worked out scheme which (in the hope of mutual financial benefit) was shaped and moulded by the fiscal possibilities. The position was that O.I. had the prospect of receiving a sum of £800,000 tax paid and it had other assets of a value of about £700,000. The price which the Appellants agreed to pay and did pay H for the shares in the first instance was £1,323,945. They were also to pay a further sum based upon the extent of the assets of Spencer. In round figures the Appellants paid £1,700,000. The vendors were, however, under the terms of a stakeholder agreement (also made on 30th March 1960), to leave £200,000 of that amount with stakeholders. One very singular provision of the sale agreement was as follows:

I " 5. The Principal Shareholders hereby severally and jointly undertake and warrant to F.A. & A.B. as follows: . . . (*d*) That the profits of Elm Tree at the date hereof (other than profits on capital account) available for distribution by way of dividend to the Company shall be sufficient to declare a gross dividend which after deduction of tax at the standard

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rate in force at the date of payment shall leave the net sum of eight hundred thousand pounds and that if a dividend or dividends shall be declared at any time by the Company to F.A. & A.B. out of the said dividend so received by it F.A. & A.B. shall be entitled to and shall recover from the Commissioners of Inland Revenue either directly or by way of set off the tax deducted by the Company in paying such dividend Provided Always that if F.A. & A.B. shall fail to recover any such tax the Shareholders will pay to F.A. & A.B. by way of liquidated damages for breach of this undertaking the difference between a sum equal to one half of the Tax recovered and the sum of Two hundred thousand pounds."

Clause 9(*b*) of the sale agreement was as follows:

"9. F.A. & A.B. hereby agrees with the Principal Shareholders that it will— . . . (*b*) proceed with due diligence to claim and recover from the Commissioners of Inland Revenue the tax deducted by the Company from any dividend declared by it out of the dividend received by it and referred to in Clause 5(*c*) hereof Provided Always that F.A. & A.B. shall not be required to procure the declaration of any such dividend unless and until it is satisfied that Elm Tree is or is treated by the Revenue as carrying on a trade or business to which section 19 Finance Act 1937 applies."

Clause 3 of the stakeholder agreement was as follows:

"3. Subject to the preceding clause the Stakeholder shall hold the said sum of Two hundred thousand pounds upon trust to release to the Shareholders the said sum or a sum equal to one half of any tax recovered by F.A. & A.B. in accordance with Clause 5(*e*) of the Sale Agreement."

The reference to clause 5(*e*) was clearly intended as a reference to clause 5(*d*).

On 30th March 1961 Elm Tree declared a dividend of £800,000 net of tax: that was paid to O.I. Ltd.: O.I. Ltd. declared a dividend of £800,000 to the Appellants. So the Appellants paid £1,700,000 for the shares, but the sellers were to leave £200,000 of that amount with stakeholders lest the sellers should be liable to pay "liquidated damages" for breach of the remarkable warranty that they gave. That was that the purchasers from them would be entitled to and would make recovery from the Revenue of tax deducted. After the payment by O.I. Ltd. of the £800,000 dividend the Appellants said that the shares for which they had paid £1,700,000 were then worth nearly £1,000,000 less. So they said there was a loss in trade and they claimed to recover tax paid of approximately £400,000. If they failed to recover tax the vendors (the Gill family) would have to pay them "liquidated damages" of £200,000. In that event the purchase price of the shares would in round figures be £1,500,000. If tax of £400,000 were recovered the vendors would get their £1,700,000, and the Appellants would have shares worth about £700,000 and would have received the £800,000 dividend and £400,000 from the Revenue. So the position was that purchasers of shares were giving an undertaking to their vendors that they would make a "loss" and would then make a claim under s. 341 of the Income Tax Act 1952. The sellers were giving a warranty to their purchasers of their entitlement to recovery of tax from the Revenue. The vendors were directly and financially interested in the result of the purchasers' promised claim under s. 341. If there was no tax recovery they would receive £200,000 less because of their liability to pay "liquidated damages".

It was submitted that the truly strange arrangements which I have summarised were but the arrangements of a trading transaction of a dealer in shares.

A It was further submitted that the elaborate and unusual provisions which were entered into merely reflected the fact that the shares possessed a special value if sold to a dealer in shares. I cannot accept these submissions. It would be a complete delusion to regard the transaction in this case as a share-dealing transaction coming within the area of trade of a dealer in shares. It was something very different.

B I would dismiss the appeal.

Lord Guest—My Lords, in the present appeal the Crown has been successful before Megarry J. and the Court of Appeal. There are two cases in which dividend-stripping was involved in which a different result has been arrived at by this House. The question was whether a particular transaction was a concern in the nature of trade within the meaning of the Income Tax Acts as affecting a C loss claim under s. 341 of the Income Tax Act 1952. These cases are *J. P. Harrison* (*Watford*) *Ltd.* v. *Griffiths*(1) [1963] A.C. 1 and *Finsbury Securities Ltd.* v. *Bishop* 43 T.C. 591; [1966] 1 W.L.R. 1402. In the former the transaction was held to be a trading transaction and in the latter the opposite result was reached. In my view, there is no inconsistency between these two cases. In *Harrison* what the House decided by a majority was that the mere fact that a D transaction was entered into with the purpose of making a loss and with no hope of making a profit, and with a fiscal motive, did not prevent it from being a trading transaction: see my noble and learned friend Lord Morris of Borth-y-Gest, [1963] A.C.1 at pages 22–3(2), and my own speech at pages 26–7(3). The only transaction in question was the purchase of shares by a dealer who intended to do a " dividend-strip ". In the *Finsbury* case(4) the House considered that E by reason of the whole nature of the transaction it could not be a trading transaction. I refer particularly to the passage in the speech of my noble and learned friend Lord Morris of Borth-y-Gest [1966] 1 W.L.R. 1402, at pages 1416–8(5).

It was argued for the Appellants in this case that features which were present in *Finsbury* were not present in this case, and that accordingly the *ratio decidendi* of *Harrison* should apply. Each case must depend upon its own F circumstances, and, like Megarry J. in the present case, I do not find the comparison of the facts in *Finsbury* with the facts in the present case very helpful, agreeing as I do in this respect with the observations of Megarry J. [1968] 1 W.L.R. 1401, at pages 1420–1 and 1423(6). It is not a logical conclusion to say that because this is not a *Finsbury* case it therefore must be a *Harrison* case.

I have read the speech of my noble and learned friend Lord Morris of G Borth-y-Gest, where he analyses the features of the transactions in the present case. I do not repeat them, but I think they show clearly that the transactions in which the Appellants were engaged were not the transactions of a normal trade in share-dealing. The shares were not bought as stock-in-trade of a dealer in shares but as pieces of machinery with which a dividend-stripping operation might be carried out.

H I have therefore reached the conclusion that the appeal should be dismissed for the reasons given by my noble and learned friend Lord Morris of Borth-y-Gest.

Viscount Dilhorne—My Lords, in July 1965 the Appellants' appeal against an assessment to income tax was heard by the Commissioners for Special Purposes. They claimed that they had suffered losses in their trade as dealers in stocks and shares as a result of the acquisition by them of shares in five I companies. Each acquisition was followed by " dividend-stripping ", and the question the Commissioners had to decide in relation to each transaction was, were the shares acquired by the Appellants in the course of their trade.

(1) 40 T.C. 281. (2) *Ibid.*, at pp. 301–2. (3) *Ibid.*, at pp. 303–4. (4) 43 T.C. 591. (5) *Ibid.*, at pp. 626–8. (6) *See* pages 598–600 and 601 *ante*.

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The Commissioners held that they were. On appeal Megarry J. held that they were not. The Appellants did not appeal against his decision in respect of the acquisition of shares in four of the companies, but appealed against his decision in relation to the shares in an investment company called Oakroyd Investments Ltd. (hereafter called " O.I. Ltd."). In the Court of Appeal their appeal was dismissed by a majority (Lord Denning M.R. and Phillimore L.J., Sachs L.J. dissenting), and they now appeal to this House. A B

The total cost of the acquisition of all the shares in O.I. Ltd. was £1,678,932. They were bought on 31st March 1960. On 31st March 1961 they were worth, according to a valuation by Cooper Bros., £695,952. The Appellants say that for income tax purposes they have sustained a loss of the difference between these figures, namely, a loss of £982,980. The greater part of that loss in the value of the shares was due to O.I. Ltd. in the year ended 31st March 1961 paying dividends amounting to £800,000 after deduction of tax to the Appellants on the shares acquired by them. The balance of the " loss ", amounting to £182,980, was described as a commercial loss. Although by reason of the declaration of the dividends the value of the shares was reduced by £800,000, as the Appellants received those dividends they did not in fact suffer any loss. The difference between the value of the shares bought and their value at the end of the year had been received by them in cash. Nevertheless, they assert that for the purposes of income tax they must be treated as having suffered that loss. They rely on the decision of this House in *Commissioners of Inland Revenue* v. *F. S. Securities Ltd.*(1) [1965] A.C. 631. In that case the question to be decided was whether dividends declared in a dividend-stripping operation were to be included in the profit and loss account of the company which received them. They were paid after deduction of tax. The Crown contended that they should be left out of the account, and it was held that they should not enter into the computation of the company's profits for the purposes of Schedule D, with the result that they fell to be treated as investment income. Consequently, a surtax direction under s. 245 of the Income Tax Act 1952 requiring the actual income of the company to be deemed to be the income of its members was held to have been rightly given. C D E F

As such dividends paid after deduction of tax are excluded in computing the profits of the company which received them for income tax purposes, so, by virtue of s. 341(3) of the Income Tax Act 1952, they have to be ignored in computing a loss for tax purposes. Section 341(3) is in the following terms:

> " (3) For the purposes of this section, the amount of a loss sustained in a trade shall be computed in like manner as the profits or gains arising or accruing from the trade are computed under the provisions of this Act applicable to Case I of Schedule D." G

So far as material the rest of that section reads as follows:

> " (1) Where any person sustains a loss in any trade . . . he may . . . apply to the General Commissioners or to the Special Commissioners for an adjustment of his liability by reference to the loss and to the aggregate amount of his income for the year estimated according to this Act. (2) The Commissioners shall, upon proof to their satisfaction of the amount of the loss . . . give a certificate authorising repayment of so much of the sum paid for tax as would represent the tax upon income equal to the amount of the loss . . . " H I

(1) 41 T.C. 666.

A Although s. 341(2) speaks of authorising repayment of so much of the sum paid for tax, no point has been taken in this case that the provisions of this section do not apply as the amount claimed by the Appellants under this section has not been paid by the Appellants in tax. If they succeed, the amount they will obtain from the Revenue will not be a repayment of tax paid by them. It will be a gain they secure by creating a " loss " by the declaration of dividends, B when in fact they suffer no loss, a profit they secure for themselves not by dealing in stocks and shares but by taking advantage of the law relating to income tax.

The full character of the operation is revealed by two documents, the agreement for the sale of the shares and a stakeholders' agreement, both made on 30th March 1960. By the sale agreement the Appellants agreed to buy from four gentlemen named Gill (hereafter called "the shareholders ") all the shares C in O.I. Ltd. for £1,323,946. O.I. Ltd. owned all the shares in Elm Tree Industrial Finance Co. Ltd. (hereafter called "Elm Tree") and Elm Tree owned nearly all the shares in the Spencer Wire Co. Ltd. (hereafter called " Spencer "). The agreement provided that, if the book debts owned by Spencer on 31st March 1960 and recovered exceeded the liabilities of that company, the excess should be added to the purchase price of the O.I. Ltd. shares. The excess amounted to D £336,402. So the price paid under the agreement for the O.I. shares was £1,660,348, which with the cost of acquiring the shares in Spencer not owned by Elm Tree (£13,200) and legal costs (£5,384) brought the total cost of acquisition to £1,678,932. The agreement provided that the sale should be completed the next day. It was. The parties presumably thought it desirable that that should happen before the end of the financial year. By clause 5(*d*) of the agreement E the shareholders undertook and warranted that the profits of Elm Tree available for distribution by way of dividend were sufficient to declare a gross dividend which after deduction of income tax would amount to £800,000. They further undertook and warranted that if dividends should be declared by O.I. Ltd. " out of the said dividend so received by it " the Appellants would be entitled to and would recover from the Inland Revenue the amount of the tax deducted F by O.I. Ltd. on paying the dividends. By clause 9(*b*) the Appellants undertook to " proceed with due diligence to claim and recover from the Commissioners of Inland Revenue " the tax deducted by O.I. Ltd. The tax so deducted amounted to £310,000.

So it was an essential feature of the sale agreement that it should be followed by dividend-stripping and a claim against the Inland Revenue for the amount G of the tax deducted. The shareholders not only got full value for their shares without incurring the liability to surtax which they would have incurred if O.I. Ltd. had declared the dividends while they were the owners of the shares, but also an interest in the claim against the Revenue, for clause 5(*d*) was subject to the proviso that if the Appellants failed to recover " any such tax ", that is to say, the tax deducted by O.I. Ltd., the shareholders would pay them " the difference H between a sum equal to one-half of the tax recovered and the sum of two hundred thousand pounds." The stakeholders' agreement provided for the retention by a bank of the sum of £200,000 deposited with them by the shareholders pending the result of the claim. So if no sum was obtained from the Revenue the Appellants were to receive from the shareholders the £200,000 and the cost to them of the purchase of the shares would be reduced by that amount. If the I claim was only partially successful, part of the £200,000 would go to the Appellants and part to the shareholders: if wholly successful, the shareholders would keep the £200,000.

On these facts the operation in which the Appellants engaged cannot, in my opinion, be regarded as one which came within the scope of the trade of

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a dealer in stocks and shares. This is not a case where the Appellants sought to make a profit by the exercise of their trade. The sale agreement shows that that was not contemplated. In my view, it would be wrong to hold that the shares were acquired for the purpose of and in the course of carrying on their trade unless it was established that the implementation of schemes for extracting money from the Revenue forms part of the trade of a dealer in stocks and shares —and the Appellants did not have the temerity to argue that that was the case. To succeed on a claim under s. 341 against the Revenue the claimants must establish that they have suffered a loss in their trade. The fact that the vendors of the shares have an interest in the claim against the Revenue being successful may be a strong indication that the purchase and sale of the shares was not a trading activity but one designed for fiscal ends, but the absence of any such participation does not mean that the operation is to be regarded as a trading activity. Participation by the vendors will not convert a trading activity of the dealers into a non-trading one, nor will absence of participation convert a non-trading activity into a trading one.

It was strongly and persuasively argued by Mr. Templeman that the decision in this House in *Griffiths* v. *J. P. Harrison* (*Watford*) *Ltd.*(1) [1963] A.C.1 governs the present case; that the facts of that case and this are really indistinguishable in any material particular; and that one cannot, therefore, reach the conclusions which I have expressed without departing from the doctrine of *stare decisis*, which this House by its Practice Direction of 26th July 1966 [1966] 1 W.L.R. 1234 declared was in its power to do. Mr. Monroe invited the House to reconsider the decision in *Harrison*. The facts of that case can be shortly stated. The company carried on business as merchants. For the year 1952–53 it incurred a loss. In 1953 it altered its memorandum of association so as to enable it to deal in stocks and shares. In the year 1953–54 it had one transaction in shares. It bought all the shares in another company "pregnant with dividend", borrowing £15,900 for the purpose. The Commissioners found that the company purchased the shares " with a view to obtaining a dividend against which it could claim to set off its losses". A dividend of £15,900 was declared and Harrisons used that to repay the loan. They then sold the shares for £1,000 and made a claim against the Revenue under s. 341. Just as in this case the purchase and sale of the shares had not caused them a loss, as they had received the difference between the purchase and sale prices by way of dividend. The Commissioners held that the transaction in these shares was not entered into as part of any trade of dealing in shares. Viscount Simonds, [1963] A.C.1, at page 11(2), said:

> " Here was a company whose object it was to deal in shares. It entered into a commercial transaction which, though it might be given an invidious name, contained no element of impropriety, much less of illegality. I can find nothing that enables me to say that it is not a trading transaction"; and at page 12(3): " It appears to me to be wholly immaterial, so long as the transaction is not a sham . . . what may be the fiscal result or the ulterior fiscal object of the transaction" .

My noble and learned friend Lord Morris of Borth-y-Gest said, at page 23(4):

> " The company bought the shares, received a dividend and then sold the shares. These facts seem to me to point firmly to the conclusion that the transaction was entered into as part of a trade of dealing in shares ".

(1) 40 T.C. 281. (2) *Ibid.*, at p. 293. (3) *Ibid.*, at p. 294. (4) *Ibid.*, at p. 301.

A And my noble and learned friend Lord Guest at page 27(1) said:

> "The company had power to deal in shares, they bought shares, they received a dividend on these shares, they sold the shares. This was just the ordinary commercial transaction of a dealer in shares."

My noble and learned friends Lord Reid and Lord Denning took a different view, Lord Reid saying, at page 13(2):

B
> "If I am entitled to have regard to the substance of the transaction, the real question appears to me to be whether acquiring a dividend which has borne tax for the sole purpose of using it to recover tax from the Revenue must be held to be trading, because in the course of acquiring it shares were bought and sold."

In his view the Commissioners were entitled to say it was not trading. Lord
C Denning, at page 22(3), said:

> "To my mind, the commissioners were entitled to see these people as they really are, prospectors digging for wealth in the subterranean passages of the Revenue, searching for tax repayments. They are not simple traders dealing in stocks and shares."

I have cited these passages for two reasons: first, they show the similarity
D between the facts of that case and of this and of the questions to be determined, and, secondly, because they appear to me to show that the majority of the House were of the opinion that the purchase and sale of the shares and the receipt of the dividend was a trading activity. My noble and learned friend Lord Morris of Borth-y-Gest said, at page 23(4), that it seemed to him that a trading transaction does not cease to be such merely because it is entered into in the confident hope
E that, under an existing state of the law, some fiscal advantage will result. I respectfully agree with that. If a transaction is established to be a trading transaction, it does not lose its character in consequence of a fiscal advantage. But as I read the case, that does not appear to have been the question at issue. It was not did a trading transaction cease to be one, but was it a trading transaction in the first place. If my reading of that decision is correct, then it appears
F to follow that in every case where a dealer in stocks and shares buys shares for the purpose of dividend-stripping, receives a dividend and sells the shares, that should be regarded as a trading activity.

This House, however, in *Bishop* v. *Finsbury Securities Ltd.*(5) [1966] 1 W.L.R. 1402 did not so treat the transactions in that case. They were more complicated and involved no less than 15 companies which were to be stripped by the use of
G preference shares carrying special rights. There were two types of transaction of which that in relation to a company called Warshaw & Sons Ltd. was taken as an example of what took place in twelve of them. The preference shares created were to carry special rights for five years and were held by two Mr. Warshaws. It is not necessary for me to state the facts in detail. The effect of the arrangement was summarised by my noble and learned friend Lord Morris
H of Borth-y-Gest, with whose speech the other members of the House agreed, as follows(6):

> "In the five-year period the two Mr. Warshaws would receive or be entitled to receive in one way or another and at one time or another all the net profits of the Warshaw company. If the scheme worked they would additionally receive one-half of the tax deducted from the dividends.

(1) 40 T.C. 281, at p. 304. (2) *Ibid.*, at p. 295. (3) *Ibid.*, at p. 300. (4) *Ibid.*, at p. 301.
(5) 43 T.C. 591. (6) *Ibid.*, at p. 624.

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> So far as the company [Finsbury] was concerned apart from paying £100 for the preferred shares they would have to pay the vendors of the shares no more than the net amount that they received from Warshaw. If they recovered tax attributable to the tax deducted from the gross dividends received from Warshaw they would have to pay half of it to the vendors but could retain the other half. Apart from the division of the amount of any tax that the Revenue might have to repay or to lose, and apart from any expenses involved in the making and the operating of these singular arrangements, it seems clear that the vendors (the two Mr. Warshaws) did not stand to lose and that the company did not stand to gain."

In the case of the other three companies, Lord Morris said, at page 1414(1): " . . . the result would be that the division of the spoil, or, in other words, the tax to be recovered if ingenuity triumphed, would not be on a fifty-fifty basis but would be in other proportions." Although in the *Finsbury* case(2) many more shares were purchased and many more dividends received, the transactions were held not to be an adventure or concern in the nature of trade. My noble and learned friend said, at page 1418(3): " It was a wholly artificial device remote from trade to secure a tax advantage."

My Lords, it was not suggested in this case that the arrangements were a sham. They were real and effective. I must confess I do not understand why the device was described as artificial. It appears to me no more and no less artificial than the device in *Harrison*(4). My noble and learned friend Lord Morris distinguished the decision in that case. Having read his speech more than once and with the greatest care, I regret that I cannot myself see that the two cases are really distinguishable. His approach in *Finsbury* was that the transaction in *Harrison* was " demonstrably a share-dealing transaction " and that a fiscal advantage did not change its character. If this view of *Harrison* is right—and by reason of the passages I have cited from the speeches in that case I feel some doubt whether it is—then the decision in that case in no way inhibits the conclusions I have reached in this case. In *Finsbury* my noble and learned friend attached importance to the position of the vendors of the shares and contrasted that with the position of the vendors in *Harrison*, pointing out that in *Finsbury* they were to receive a share of the tax recovered. While I do not doubt that it is right to have regard to the position of the vendors and that in some cases that may be illuminating, I do not see how an arrangement between the purchasers and vendors to share the proceeds of any tax recovered can alter or affect the nature of the purchaser's activity. A dealer trading in stocks and shares does not cease to trade in them if he agrees to share with the vendor as part of the purchase price any profit he makes.

My Lords, if there is no valid ground for distinguishing between the two cases, the choice must lie between following *Harrison* or *Finsbury*, in which case I would unhesitatingly follow *Finsbury*, for that decision is, I think, clear authority for the proposition that dividend-stripping activities involving the purchase of shares and the receipt of dividends may be outside the scope of the trade of a dealer in stocks and shares. My Lords, if a transaction viewed as a whole is one entered into and carried out for the purpose of establishing a claim against the Revenue under s. 341, I for my part would have no hesitation in holding that it does not form part of the trading activities of a dealer in stocks and shares. When I say " viewed as a whole ", I mean that regard must be had not only to the inception of the transaction, to the arrangements made

(1) 43 T.C. 591, at p. 624. (2) 43 T.C. 591. (3) *Ibid.*, at p. 627. (4) 40 T.C. 281.

A initially, but also to the manner of its implementation. If it be the case that my conclusions in this case conflict with the decision in *Harrison*([1]), then I must respectfully decline to follow that decision.

For the reasons I have stated, there was not in this case, in my opinion, any loss in the trade of a dealer in stocks and shares and so this appeal should be dismissed.

B **Lord Donovan**—My Lords, the ordinary trader in stocks and shares normally makes his purchases on the attractions of the investments as a merchantable commodity: e.g., the soundness of the underlying assets, the potentiality for growth, the quality of the relevant management, the interim yield, and so on. The purchase of the Oakroyd shares was not decided upon by the present Appellants as the result of any such commercial appraisement. They were C bought pursuant to a plan having as its objects (*a*) to provide the Gill family with the equivalent in capital of certain undistributed profits which if taken by way of dividend would attract surtax and (*b*) to provide the Appellants with an opportunity to compel the Revenue to pay to them a large sum of money which they, the Appellants, had never themselves disbursed in tax, and which on recovery they would share with the vendors of the shares. I say that this is D not trading in stocks and shares. If I am asked what it is, I would reply that it is the planning and execution of a raid on the Treasury using the technicalities of revenue law and company law as the necessary weapons.

There is an obvious distinction between this kind of case and the case where fiscal advantages are incidental. The House drew that distinction in *Finsbury Securities Ltd.* v. *Bishop*([2]) [1966] 3 All E.R. 105 when confronted with E its previous decision in *Griffiths* v. *J. P. Harrison* (*Watford*) *Ltd.* [1963] A.C.1. Any difficulties which have arisen in cases subsequent to *Finsbury* have arisen, not because of the nature of this distinction, which is simple and clear enough, but because the case of *Harrison* was also a case where the fiscal advantage was the sole objective; and it is not easy, therefore, to see why it should be treated as the opposite of *Finsbury*. In the *Harrison* case the majority view, as I read F the speeches which express it, is reached by examining the component parts of the transaction, i.e., the purchase of shares, the receipt of a dividend and the sale of the shares, and proceeding thence to the conclusion that these things when done by a dealer in shares amount to trading in shares. It is irrelevant that such trading had a fiscal advantage in view. The minority view, on the other hand, does not confine itself to examining the ingredients of the transaction G but recognises that its totality may be different from the mere sum of its parts. This comes out clearly in the speeches of Lord Reid and Lord Denning. And the totality of the transaction was held by them not to be a trading transaction because, when viewed as a whole, it stood revealed as a device for extracting money from the Exchequer and nothing else.

In the *Finsbury* case the component parts of the transactions if considered H alone would logically have produced the same decision as in *Harrison*. There were shares acquired, dividends received, and shares disposed of. But this time the House did take a comprehensive view of the transaction as a whole; and taking that view reached the conclusion that " It was a wholly artificial device remote from trade to secure a tax advantage "([3]): [1966] 1 W.L.R., at page 1418. It is immaterial in principle that the wider view was induced I by certain unusual features in *Finsbury*. The altered approach, with which I respectfully agree, must now clearly be taken to be right.

I would dismiss this appeal.

([1]) 40 T.C. 281. ([2]) 43 T.C. 591. ([3]) *Ibid.*, at p. 627.

Lord Simon of Glaisdale—My Lords, much of the argument before your Lordships, as in the Courts below, was concerned with the decisions in *Griffiths* v. *J. P. Harrison* (*Watford*) *Ltd.*(1) [1963] A.C. 1 and *Bishop* v. *Finsbury Securities Ltd.*(2) [1966] 1 W.L.R. 1402, with their inter-relationship, and with whether the instant case fell within the precedent established by the one or the other case. Where the delightful and distinguished advocacy of counsel for the Appellants failed to carry my conviction was partly in its emphasis on particular passages in the speeches in *Harrison's* case without testing them against the decision in the *Finsbury* case, partly in concentrating on the facts in *Harrison's* case and matching them against the facts of the instant case. This was understandable; because what constitutes binding precedent is the *ratio decidendi* of a case, and this is almost always to be ascertained by an analysis of the material facts of the case—that is, generally, those facts which the tribunal whose decision is in question itself holds, expressly or implicitly, to be material. A judicial decision will often be reached by a process of reasoning which can be reduced into a sort of complex syllogism, with the major premise consisting of a pre-existing rule of law (either statutory or judge-made) and with the minor premise consisting of the material facts of the case under immediate consideration. The conclusion is the decision of the case, which may or may not establish new law—in the vast majority of cases it will be merely the application of existing law to the facts judicially ascertained. Where the decision does constitute new law, this may or may not be expressly stated as a proposition of law: frequently the new law will appear only from subsequent comparison of, on the one hand, the material facts inherent in the major premise with, on the other, the material facts which constitute the minor premise. As a result of this comparison it will often be apparent that a rule has been extended by an analogy express or implied. I take as an example a case remote from the field of jurisprudence with which your Lordships are instantly concerned, because it illustrates clearly, I think, what I have been trying to say—*National Telegraph Co.* v. *Baker* [1893] 2 Ch. 186. Major premise: the rule in *Rylands* v. *Fletcher* (1866) L.R. 1 Ex. 265; (1868) L.R. 3 H.L. 330. Minor premise: the defendant brought and stored electricity on his land for his own purpose; it escaped from the land; in so doing it injured the plaintiff's property. Conclusion: the defendant is liable in damages to the plaintiff (or would have been but for statutory protection). Analysis shows that the conclusion establishes a rule of law, which may be stated as " for the purpose of the rule in *Rylands* v. *Fletcher* electricity is analogous to water ", or " electricity is within the rule in *Rylands* v. *Fletcher* ". That conclusion is now available as the major premise in the next case, in which some substance may be in question which in this context is not perhaps clearly analogous to water but is clearly analogous to electricity. In this way, legal luminaries are constituted which guide the wayfarer across uncharted ways.

But where a legal rule is not extended by analogy, but the previous authority has been distinguished, the appropriate metaphor is no longer the single luminary, but rather those binary stars each part of which lives within the field of the other and is essentially influenced by it. Sometimes it seems as if the twin has been formed by the breaking away of a substantial part of the original mass. Again I take a famous example remote from revenue law. The decision in *Donoghue* v. *Stevenson* [1932] A.C. 562 appeared to establish a far wider proposition of law than was evident after it had been distinguished in *Farr* v. *Butters* [1932] 2 K.B. 606, albeit the former was a decision of this House and the latter of the Court of Appeal. The material facts of an earlier decision which has been distinguished must be reassessed in the light of the later decision. After a case has been distinguished, many of its facts which appeared to be material,

(1) 40 T.C. 281. (2) 43 T.C. 591.

A perhaps even to the original tribunal of decision, can often no longer be considered to be so. The earlier case can now only operate within the field of influence of the case which distinguishes it.

Adopting such an approach, and reading *Harrison's* case[1] in the light of the *Finsbury* case[2], it is clear that the former was a very narrow decision indeed, and that particular caution is required in the use of passages from the speeches B in the former case which cannot be reconciled with the decision (or indeed the language of judgment) of the latter. In my view, the two cases, taken as a binary system, establish the following propositions: (1) the question in every case is whether the relevant loss has been incurred in the course of trade (of dealing in shares); (2) dividend-stripping (or any other transaction to secure a fiscal advantage) is not in itself part of the trade of dealing in shares (cf. also C *Commissioners of Inland Revenue* v. *Dowdall O'Mahoney & Co. Ltd.* [3] [1952] A.C. 401); (3) share-dealings and other business transactions vary almost infinitely; and to determine whether the transaction is, on the one hand, a share-dealing which is part of the trade of dealing in shares or, on the other, merely a device to secure a fiscal advantage, all the circumstances of the particular case must be considered; (4) a share-dealing which is palpably part of the trade of D dealing in shares will not cease to be so merely because there is inherent in it an intention to obtain a fiscal advantage, or even if that intention conditions the form which such share-dealing takes; (5) what is in reality merely a device to secure a fiscal advantage will not become part of the trade of dealing in shares just because it is given the trappings normally associated with a share-dealing within the trade of dealing in shares; (6) if the appearance of the trans- E action leaves the matter in doubt, an examination of its paramount object will always be relevant and will generally be decisive (see also *Iswera* v. *Commissioner of Inland Revenue* [1965] 1 W.L.R. 663, especially at page 668). The foregoing is merely an elaboration of what was said by Buckley J. in *Cooper* v. *Sandiford Investments Ltd.*[4] [1967] 1 W.L.R. 1351, at page 1361, and by Megarry J. at first instance in the case under appeal [1968] 1 W.L.R., at pages 1417B, F 1418F and 1419E–1420A[5].

My Lords, if the foregoing are correct propositions of law there can be no doubt as to the outcome of this appeal. I have had the advantage of reading the speech prepared by my noble and learned friend Viscount Dilhorne, and I agree with his analysis and description of the transactions with which your Lordships are concerned. Such trappings of the trade of dealing in shares as G we have here are quite inadequate to prevent the real nature of this transaction showing through. The sale agreement of 30th March 1960 contains a warranty by the vendors that the Appellants would be entitled to and would recover from the Inland Revenue the amount of the tax deducted from the dividends to be paid on the shares and provides for " liquidated damages " for breach of the warranty; while the collateral " stakeholder agreement " was designed to H insure the Appellants further against anything going wrong with the claim against the Inland Revenue (e.g., through premature intervention by the Legislature). So far as the vendors were concerned, the effect of the " stakeholder agreement " was that the price the vendors would receive for the shares (itself, in any event, representing past profits in a surtax-free form) depended on the degree of success of the Appellants' claim for repayment of tax; while the vendors' I interests in this regard were safeguarded by the Appellants' undertaking in the principal agreement to " proceed with due diligence to claim and recover from the Commissioners of Inland Revenue the tax deducted by the Company

(1) 40 T.C. 281. (2) 43 T.C. 591. (3) 33 T.C. 259. (4) 44 T.C. 355, at p. 364.
(5) *See* pages 596B, 597D/E and 598B/E *ante*.

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[i.e. Elm Tree] from any dividend received by it ". The interposition of Elm Tree was calculated to obviate the anti-dividend-stripping provisions of s. 4 of the Finance (No. 2) Act 1955. A

My Lords, this is not share-dealing within the trade of dealing in shares. It is plainly a joint venture of the Appellants and the vendors of the shares, by taking advantage of quirks of revenue and company law, to obtain money out of the public purse and share it between them. Even if the transaction were equivocal, its true nature would, in my view, be resolved by investigation of its paramount object: since, on the findings of the Special Commissioners, the transaction would produce a loss to the Appellants unless repayment of income tax were obtained, I conclude that the paramount object of the transaction was to procure such repayment of income tax: it was, in other words, a tax-recovery device. B C

I would dismiss the appeal.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Herbert Smith & Co.]