The Ramsay Principle: Does It Now Apply in Australia?

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Introduction

The last decade has seen an explosion the world over in measures taken to combat the avoidance of taxation. There is a new government consciousness of the technical loopholes which were exploited in reducing tax liability. Many of these loopholes have been closed by revising substantive provisions or introducing specific anti-avoidance provisions within a particular division or part of the tax legislation. Further, some governments such as Australia have enacted general anti-avoidance provisions to catch any residual schemes falling outside the specific provisions.

By contrast, the English courts developed a new anti-avoidance doctrine known as the *Ramsay* principle (after the case of *W.T. Ramsay* v. *I.R.C.*[1]). At the time this principle was introduced in the United Kingdom, there was considerable speculation in Australia whether the principle would apply in this country. Traditionally, Australian courts have paid great deference to United Kingdom tax doctrines, notwithstanding the fact that the legislative scheme in that country is completely unlike the Australian regime. One key difference is the inclusion of the general anti-avoidance provision in the Commonwealth *Income Tax Assessment Act* 1936, a difference that many suggested would cause Australian courts to reject the English anti-avoidance principle. These observers proved correct and in the case of *John* v. *F.C.T.*[2] the Australian High Court confirmed that the English principle would not be followed in Australia.

The *Ramsay* principle has recently been revitalised in the United Kingdom by the decision of the House of Lords in *Ensign Tankers (Leasing) Ltd* v. *Stokes.*[3] Some observers have queried whether this re-endorsement and refinement of the English principle by the House of Lords will cause the Australian High Court to reconsider its position. This article considers that possibility and contrasts the application of the *Ramsay* principle with that of Part IV A of the *Income Tax Assessment Act* 1936 (hereafter all section references are to the latter Act unless otherwise indicated).

The analysis initially proceeds in a chronological fashion. The first part of the article explores the development of the English doctrine up to the time it was considered by the Australian High Court in *John's* case. The evolution of the English principle is considered in terms of the leading English cases in the area. The second part of the article reviews the High Court's decision in *John's* case and analyses the basis for rejection of the English principle. The third part examines *Ensign Tankers* and how it builds upon the earlier English case law. The last part of the article deals with the potential impact the developments in *Ensign Tankers* may have in Australia.

I. Development of the Ramsay Principle

Tracing the development of the *Ramsay* principle will begin by considering the tradi-

1 [1982] A.C. 300
2 (1988) 166 C.L.R. 417.
3 [1992] 2 All E.R. 275.

tional position in the case of the *Duke of Westminster*.[4] Then the facts and decisions in the four leading cases which developed the *Ramsay* principle will be considered.

(a) *IRC* v. *Duke of Westminster*

In the *Duke of Westminster* case, the Duke by deed covenanted to pay his gardener an annuity. The gardener by letter volunteered that while this annuity was being paid he would only draw half wages. The motive behind the transaction was clear; the gardener's wages were not deductible for the Duke but the annuity was. The deed was held not to be a sham because the Duke was bound to make the annuity payment even after the gardener's employment ceased. The scheme was upheld and the deduction available. The principle involved in this case was that: 'Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance.'[5] This became known as the *Westminster* doctrine.

(b) *F.A. & A.B. Ltd.* v. *Lupton*[6]

Luptons's case was a classic case of a dividend strip. The taxpayer, being a trader in shares bought shares just before the company was to pay a large, taxed dividend. The dividend was paid, thereby reducing the value of the shares. The taxpayer sold the shares at a loss and claimed the deduction. The financial effect of the transactions to the share trader were nil. The money he had spent on the shares had been returned in full in the form of the dividend and the money received from the sale of the shares. The House of Lords held that since the object of the taxpayer was to secure a tax advantage the transaction was not dealing in shares and not part of its trade. Viscount Dilhorne said:

> [I]f a transaction viewed as a whole is one entered into and carried out for the purpose of establishing a claim against the Revenue ... 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.[7]

(c) *W.T. Ramsay Ltd* v. *I.R.C.*[8]

The taxpayer in *Ramsay's* case wished to manufacture a capital loss to reduce an existing capital gain, so it purchased a capital loss scheme. While the precise terms of this scheme are not relevant for present purposes it did involve the use of a company and two loans. In the result the taxpayer had returned to it all the funds it had provided by way of loan but in the course of the scheme had 'magically' incurred a capital loss equivalent to the capital gain it wished to offset. So the financial effect on the taxpayer of the transactions was similar to that in *Lupton's* case, i.e. neither gain nor loss; it was a circular self-cancelling transaction. In the words of Lord Wilberforce:

> On these facts it would be quite wrong, and a faulty analysis, to pick out, and stop at, the one step in the combination which produced the loss, that being entirely dependent on, and merely a reflection of, the gain. The true view, regarding the scheme as a whole, is to find that there was neither gain nor loss, and I so conclude.[9]

In *Ramsay*, the House of Lords did not seek to overrule the *Westminster* doctrine but rather to apply it, without overstating or overextending it,[10] to a series of transactions. The development in *Ramsay* was stated by Lord Wilberforce as follows:

> It is the task of the court to ascertain the legal nature of any transaction to which it is sought to

4 [1936] A.C. 1.
5 *W.T. Ramsay* v. *IRC* [1982] A.C. 300, 323 per Lord Wilberforce.
6 [1972] A.C. 634.
7 *Id.* 657.
8 [1982] A.C. 300.
9 *Id.* 328.
10 *Id.* 323 per Lord Wilberforce.

> attach a tax or a tax consequence and if that emerges from a series or a combination of transactions, intended to operate as such, it is that series or combination which may be regarded.[11]

(d) *Furniss* v. *Dawson*[12]

Dawson's case developed the *Ramsay* principle by applying it to a lineal series of transactions. The taxpayer wished to sell his shares in a private company. In order to defer the payment of C.G.T. on the gain which would be realised on the sale of these shares, the taxpayer purchased a company to which he transferred these shares in exchange for shares in that company. This intermediate company then sold the original shares to the ultimate purchaser. The taxpayer argued that roll-over relief was available. This was a simple tax deferral device. The House of Lords held that, looking at the transactions as a whole, the legal nature of these transactions was that the taxpayer had disposed of his shares directly to the purchaser in return for consideration paid to the intermediate company, therefore C.G.T. was payable immediately. Lord Brightman stated the *Ramsay* principle in these terms:

> First, there must be a pre-ordained series of transactions; or, if one likes, a single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (i.e. business) end ... Second, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax- not 'no business effect'. If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes.[13]

It is this *Dawson* extension to the *Ramsay* principle which has caused much criticism and debate because it requires an artificial reconstruction of the parties' transactions.[14]

(e) *Craven* v. *White*[15]

Craven v. *White* is seen as a narrowing of the *Dawson* extension to the *Ramsay* principle. This case concerned facts similar to *Dawson*, the difference being that after the share exchange with the intermediate company there were various delays before the ultimate sale to the purchaser. The case focused on the issue of whether the steps in the various transactions were pre-ordained or a series of transactions. The court held the parties' actions were not pre-ordained and therefore the *Ramsay* principle was not applicable.

II. John's Case Rejects the Ramsay Principle

The *Ramsay* principle as formulated by Lord Brightman in *Dawson's* case was rejected as applicable in Australia by a single judgment of five High Court Justices[16] in *John's* case.[17] They held: '[T]here is no warrant for limiting s.51 by reference to the quite specific ingredients identified by Lord Brightman in *Furniss* (*Dawson's* case).'[18]

The following discussion of *John's* case will first consider the facts of the case, then outline the taxation advantage sought by Mrs John, and finally follow the reasoning of the High Court in dealing with the Commissioner's arguments as to why the taxation advantage was not available.

(a) *Facts of John* v. *F.C.T.*

The taxpayer was a partner in a partnership which from its formation engaged in share trading. The partnership bought and sold half the issued shares in five companies. On

11 *Ibid.*
12 [1984] A.C. 474.
13 *Id.* 527.
14 See the list of issues and doubts in the U.K. *Tax Guide* 1992-93, 17.
15 [1989] A.C. 398.
16 Mason C.J., Wilson, Dawson, Toohey, and Gaudron JJ.
17 (1988) 166 C.L.R. 417.
18 *Id.* 435.

27/4/77, it bought the shares for $2.4m. On 28/4/77, dividends were declared from a revaluation or sale of capital assets. On the same day, these dividends were used to issue a large number of paid up bonus shares. On 29/4/77, the shares and the bonus shares were sold. Less than 1% of the consideration was allotted to the original shares, the balance being allotted to the bonus shares.

(b) *The taxation advantage sought*

First, the High Court considered the transaction as a whole and said that the partnership 'made a profit in the sense that the price obtained on sale of its shareholding exceeded the expenditure incurred in its acquisition. In total that profit amounted to $1165.85.' Furthermore, 'the transactions ... had been prearranged by professional advisers ... with the view of the partnership obtaining a taxation advantage.'[19] The Court explained that advantage as:

1. In pursuance of s.44(2) (as it then was), a dividend paid in issuing bonus shares as paid up was not assessable income if the profits used by the company to pay the dividend were derived from capital assets.
2. In *Curran* v. *F.C.T.*[20] the High Court held that a share trader was entitled to deduct a dividend credited in paying up bonus shares which become his trading stock in calculating his liability to income tax, even if the dividend is not assessable income.
3. By deducting the dividend paid the partnership ended up with a $2.1m loss instead if making the $1,165 profit.
4. Via s.92(1) partners are entitled to use their share of partnership losses as a deduction. This is what Mrs John claimed.

(c) *Reasoning of the High Court*

The Commissioner argued Mrs John was not entitled to this taxation advantage for four reasons. First, it was argued that Mrs John had incurred no loss or outgoing for the purpose of s.51 and therefore was not entitled to the deduction. Secondly, it was argued that s.260[21] applied, or thirdly that the *Ramsay* principle applied. Finally, it was argued that *Curran* was wrongly decided. The High Court dealt with these arguments as follows.

(i) s.51, was there a loss or outgoing?

The High Court pointed out that on the assumption *Curran* was correctly decided, the amount credited towards the bonus shares was clearly deductible under the first limb of s.51(1).[22] The main issue under s.51 was whether, because of the taxpayer's purpose in entering the transactions to secure a tax advantage, the bonus shares were not within the definition of 'trading stock' in s.6(1). The High Court held they were trading stock because the acquisition of the bonus shares was also attended with the purpose that the shares later be sold.

(ii) s.260 not applicable

The High Court next considered the applicability of s.260, the general anti-avoidance provision.[23] The High Court rejected the argument that s.260 applied because the specific wording of that section could not be applied by reference 'to past events which themselves determine deductibility under s.51.'

(iii) Ramsay rejected

The High Court superficially considered and flatly rejected the *Ramsay* principle. The Court quoted Lord Brightman's formulation of the *Ramsay* principle but unfortunately

19 *Id.* 424.
20 (1974) 131 C.L.R. 409.
21 The former general anti-avoidance provision.
22 i.e. a loss or outgoing incurred in gaining or producing assessable income.
23 This provision has been replaced by Part IV A.

did not consider the judgment of Lord Wilberforce in *Ramsay* itself. The High Court also referred to the judgment of Lord Goff in *Craven* v. *White* where he stated the *Ramsay* principle was one of construction of the statute.[24] The High Court then referred to the maxim of statutory construction 'that where there is specific statutory provision on a topic there is no room for implication of any further matter on the same topic.'[25]

Owing to the existence of s.260 the Court held there was no room in Australian law for the *Ramsay* principle.[26] This is a most compelling argument, indeed the United Kingdom *Tax Guide* 1992-93 states that it is 'current orthodoxy, the matter (the *Ramsay* principle) is simply one of statutory construction.'[27]

(iv) Curran overruled

Mrs John ultimately failed in her appeal because the High Court held that *Curran* was incorrectly decided. Therefore, as the dividend credited in paying up the bonus shares was not an expenditure or cost associated with the acquisition of those shares, the tax advantage, being the deduction which gave rise to the partnership loss, was removed.

III. Ensign Tankers

First, this part will consider the facts of *Ensign Tankers*. Secondly, the leading judgment of Lord Templeman in the House of Lords (with whom the other members of the House agreed) will be analyzed. Thirdly, the extent to which *Ensign Tankers* develops the *Ramsay* principle will be considered.

(a) *Facts of Ensign Tankers*

Lord Templeman summarised the case as follows: 'In the present case the taxpayer claims for itself and its partners capital allowances for expenditure of $14m although the partners were never liable to spend more than $3.25m of their own money.'[28]

A U.S. company (Lorimar) which engaged in the production of films was in need of further funds for a film under production. The taxpayer and four other British companies became limited partners in a limited partnership (of which the general partner was a wholly owned subsidiary of Lorimar). This limited partnership was set up to partly finance the production and exploitation of the film to the extent of $3.25m. In return for this injection of funds, the limited partnership was to receive 25% of the net receipts of the film together with the first year depreciation allowance equal to the *total* cost of the film which was $14m. At the time, the first year depreciation allowance in respect of capital expenditure on that type of plant, namely the master negative of the film, was 100%. So the partnership sought a first year allowance of 100% of the costs of the film, even though it only provided 25% of the finance. In order to secure this result, a series of transactions were entered into between Lorimar and the partnership which included the following:

— the negative of the film was transferred to the partnership;
— Lorimar bought the right to produce the film with some of its associated companies having the right to exploit the film;
— these associates were to distribute the net profits 25% to the partnership and 75% to Lorimar;
— the partnership financed the entire film by using $3.25m of its own funds, the balance being provided by Lorimar in the form of a loan to the partnership;

24 [1988] 3 W.L.R. 423, 468.
25 (1988) 166 C.L.R. 421, 434.
26 The same reasoning applies to Part IV A.
27 U.K. *Tax Guide* 1992-93, 20.
28 [1992] 2 All E.R. 275, 278.

— this was a non-recourse loan, i.e. the loan and interest were repayable only out of receipts from the film;
— this loan ranked equally as regards payment with the $3.25m forwarded by the partnership, any excess funds lent by Lorimar to complete the film and interest on all monies loaned were only to be repaid after the partnership had been repaid the $3.25m.

At the time of the agreements the film had cost some $4.8m. The bank which had loaned Lorimar the initial funds wished that loan to be reduced by the $3.25m to be contributed by the partnership. A bank account was opened in the name of the partnership (which was controlled by Lorimar's subsidiary, the general partner), the $3.25m paid into it and on the same day these funds were paid direct to Lorimar. A few days later the balance of the $4.8m, namely $1.55m was paid by Lorimar into this bank account as loan funds and promptly paid back to Lorimar the same day as payment for the production costs it had incurred as producer of the film. After this, any funds to be loaned to the partnership by Lorimar were placed in this bank account and credited back to Lorimar the same day. Accordingly, this bank account was never in credit or debit at the close of any day and the partnership was never in 'debt' as a result of the scheme.

In summary, the partnership supplied only $3.25m of the capital and took only that quantum of risk but claimed to be entitled to the full first year depreciation allowance for the total cost of the film because of the transactions it had entered into with Lorimar. After applying the *Ramsay* principle, the House of Lords unanimously held that the partnership was entitled to an allowance of $3.25m and not $14m.

(b) *Lord Templeman's analysis of the developmental cases*

Lord Templeman's judgment considered the matters set out below.

(i) Westminster doctrine clarified

Lord Templeman clarified the current status of the *Westminster* doctrine. Clearly, the name given to a transaction by the parties is not conclusive of the nature of the transaction.[29] Just because the Duke described the payments as an annuity did not mean that the tax legislation must be applied to those payments as annuities. The financial effect of the transactions in the *Duke of Westminster* case was that the Duke was bound to pay the annuity even after the gardener's employment ceased and in the meantime was paying an amount equivalent to the gardener's wages. However, there were two differing views as to the legal arrangements. First, the view of Lord Atkin was that the gardener worked full-time for wages and agreed not to take his annuity until he had retired. Secondly, the view of the majority was that the gardener volunteered to draw only half wages. In accordance with the second view, the legal arrangements corresponded with the fiscal consequences claimed by the Duke and the deduction was available.

The *Duke of Westminster* case can be contrasted with *Ensign Tankers*. Again there were two possible views as to the legal arrangements. First, the view put forward by the parties, that the transactions revealed a non-recourse *loan* and therefore the partnership had incurred the total cost of the film, the fiscal consequence being that the entire first year allowance was available to the partnership. Secondly, the view of the court was that although the agreement was not a sham, from a legal viewpoint it was actually an equity participation of 25% disguised as a loan, the partnership had not incurred the total costs of the film, it was only liable for less than 25% of them. The tax legislation was applied in accordance with the Court's view.

(ii) Lupton distinguished

In *Ensign Tankers* the Revenue sought to use the authority of *Lupton* to deny the partner-

29 *Secretary of State in the Council of India* v. *Scoble* [1903] A.C. 299.

ship any first year allowance at all. The Revenue argued that the partnership's purpose to use the scheme to secure a tax advantage meant that the partnership had failed to trade at all, even in respect of the $3.25m actually expended.

Lord Templeman did no more than distinguish *Lupton* on the ground that in that case there was neither a profit nor loss and that in *Lupton* 'the House did not consider the present situation which on the true analysis there was trading involving an expenditure of $3.25m.'[30] His Lordship held that:

> In the present case a trading transaction can plainly be identified. Victory Partnership expended capital in the making and exploitation of a film. That was a trading transaction which was not a sham and could have resulted in either a profit or a loss.[31]

(iii) Lord Wilberforce's formulation in Ramsay followed

Ensign Tankers is a clear application of the development in *Ramsay's* case. The partnership in *Ensign Tankers* was allowed the $3.25m allowance because the legal nature of the transactions when viewed as a whole was expenditure of this amount.

Further, just as in *Ramsay*, in *Ensign Tankers* there was a circular self-cancelling transaction, the advancing of the loan funds. These funds were forwarded to the partnership bank account (controlled by Lorimar) by Lorimar and immediately returned to Lorimar. When this transaction is ignored we find that these funds were not forwarded to the partnership at all and therefore the only expenditure that the partnership incurred was the $3.25m. As Lord Templeman pointed out, if Lorimar had been a U.K. company it would have been entitled to the first year allowance itself because it had incurred the expense.

(iv) Dawson followed but not on the facts

It is noteworthy that Lord Templeman refrained from using the more famous formulation by Lord Brightman in *Dawson* of the *Ramsay* principle but instead quoted the following statement of Lord Fraser in *Dawson:*

> The true principle of the decision in *Ramsay* was that the fiscal consequences of a preordained series of transactions, intended to operate as such, are generally to be ascertained by considering the result of the series as a whole, and not by dissecting the scheme and considering each individual transaction separately.[32]

Ensign Tankers confirms that the duty of the court is to ascertain the legal effect of the parties' actions, without confirming Lord Brightman's formulation of the *Ramsay* principle.

(v) Craven v. *White not important*

Craven v. *White* was not important to the decision in *Ensign Tankers* for two reasons. First, as discussed above, *Ensign Tankers* did not require the *Dawson* extension to the *Ramsay* principle. Secondly, the fact that the transactions in *Ensign Tankers* were a series and pre-ordained was not in issue.

(c) *How does Ensign Tankers develop the Ramsay Principle?*

It is submitted that *Ensign Tankers* can be viewed from three widening perspectives. The first two perspectives do not involve development of the *Ramsay* principle, the third does.

(i) Endorsement of Ramsay

At its narrowest, *Ensign Tankers* is at least supporting authority for Lord Wilberforce's approach in *Ramsay*, without the *Dawson* extension. As discussed, on the facts of *Ensign Tankers*, all the court needed to do was apply the *Ramsay* principle to the circular self-cancelling transaction to reach its decision.

30 [1992] 2 All E.R. 275, 288 per Lord Templeman.
31 *Id.* 294.
32 [1984] A.C. 474, 512.

(ii) Endorsement of Dawson
A second view is that *Ensign Tankers* supports the *Dawson* extension to the *Ramsay* principle. While this support is not in doubt, the extension was not required on the facts to reach the decision and therefore any comment is *obiter*, albeit of the highest authority. Therefore any doubts raised as to the application of the *Dawson* extension by the case of *Craven* v. *White* remain.

(iii) The New Approach; Tax Avoidance / Tax Mitigation
The third and widest view was applied to the facts and therefore forms part of the *ratio* of *Ensign Tankers*. This approach may not even be a development of the *Ramsay* principle at all but rather a new approach altogether, the '*Ensign* Principle'.

In the course of his judgment,[33] Lord Templeman quoted from a Privy Council case on appeal from New Zealand. He said:

> In *I.R.C.* v. *Challenge Corp. Ltd* [1987] A.C. 155 at 167-168 when delivering the advice of the majority I drew the distinction between tax mitigation and tax avoidance in these terms:
>
> Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income or entitle him to reduction in his tax liability ... Income tax is avoided ... when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction.

The significance of this distinction, according to Lord Templeman, is that 'tax avoidance' falls within the *Ramsay* principle, whereas the *Westminster* doctrine applies to and protects 'tax mitigation'. Under this sub-heading this article will consider whether Lord Templeman's classifications of 'tax avoidance' or 'tax mitigation' restrict the *Ramsay* principle or provide an example of its application. Consideration is then given to the question of whether those classifications are inclusive of the *Ramsay* principle or not and the consequences.

1. Restriction of the Ramsay principle or an example of its application?
On the one hand, this distinction may be seen to restrict the *Ramsay* principle. Here it is argued that the *Ramsay* principle can only apply to 'tax avoidance' schemes and the *Westminster* doctrine only to 'tax mitigation' schemes, i.e. the *Ramsay* principle and the *Westminster* doctrine are mutually exclusive. While this may be a desirable result it is not in accordance with the approach taken by Lord Wilberforce in *Ramsay* itself where he thought he was applying the *Westminster* doctrine, not excluding it.[34]

On the other hand, the better view is that Lord Templeman merely restated the *Ramsay* principle and provided some non-exhaustive guidelines as to its application. Where there is a 'tax avoidance' scheme as defined by His Lordship, then the true legal nature of the transactions is not what the parties contend and this results in that part of the transactions which produces the artificial reduction in liability to tax being ignored. In contrast, with a 'tax mitigation' scheme the transactions involved *are* the true legal nature of the parties' dealings. The facts of *Ensign Tankers* are an example of both, the non-recourse loan being struck down as 'tax avoidance', the $3.25m being upheld as expenditure entitled to the first year allowance even though the sole purpose for the expenditure was to gain the tax advantage. The latter was a 'tax mitigation' scheme.

2. Are Lord Templeman's classifications inclusive of the Ramsay principle?
Is this distinction between 'tax avoidance' and 'tax mitigation' inclusive of the *Ramsay* principle? The better view is no, particularly if *Dawson* is a valid extension of that principle.

It is submitted that the facts of *Dawson* do not disclose a 'tax avoidance' scheme. The Dawsons merely 'deferred' tax. They exchanged assets in circumstances where, under

33 [1992] 2 All E.R. 275, 290.
34 [1982] A.C. 300, 323.

the Act, a deferral of the chargeable gain was available until the shares they received in the exchange were themselves disposed of. In *Dawson* itself, Lord Brightman said: 'My Lords, the transaction which we are called upon to consider is not a tax avoidance scheme, but a tax deferment scheme.'[35]

Further, as will be discussed later, the *Ramsay* principle has been applied in the United Kingdom to areas other than taxation. Therefore, Lord Templeman's classifications are not inclusive of the *Ramsay* principle.

It may still be argued that the two categories defined by Lord Templeman *are* inclusive of the *Ramsay* principle in the tax field alone. If this view is accepted, then *Dawson* was 'tax mitigation' not 'tax avoidance'. Lord Templeman does not agree with this classification.[36] However, it can be argued that Dawson did pay the price for their reduction in tax, i.e. the value transferred to the company in the form of the original shares which gave rise to the statutory relief remained with the company. In Lord Templeman's words the Dawson's 'income' was 'reduced' in the sense that the company received the income which the Dawsons would otherwise have received. If the Dawsons had received the proceeds of sale instead of the company, then they could not be said to have incurred the 'expenditure' entitling them to the reduction in tax in the form of the roll-over relief. In the course of his judgment, Lord Templeman referred to how a 'tax avoidance' scheme has been recognisable in some of the famous cases referred to in this article. With reference to *Dawson* he said: '[T]he taxpayer disposed of shares without apparently creating a liability to capital gains tax.'

However, *every time* a person makes use of rollover relief they dispose of shares without incurring C.G.T.: that is the purpose of roll-over relief. Lord Templeman's comments can be criticised because there *is* no 'magic' in this particular disposal without 'creating a liability to capital gains tax'. The only 'magic' is in the statutory provision providing the rollover relief. In this sense the 100% first year depreciation allowance in *Ensign Tankers* was also statutory 'magic', as was the effect of *Curran* on the transaction in *John's* case. It is submitted that *Dawson* was not a 'tax avoidance' scheme. It is therefore arguable that if this new classification of 'tax avoidance' and 'tax mitigation' is inclusive of the *Ramsay* principle, then *Ensign Tankers* may place doubt on the authority of *Dawson* because if *Dawson* is viewed as a 'tax mitigation' scheme then according to Lord Templeman the *Westminster* doctrine should have been available to protect it.

As the authority of *Dawson* cannot be doubted in the United Kingdom, indeed Lord Templeman did not doubt it, then if *Dawson* truly was not a case of 'tax avoidance', it may stand outside the *Ramsay* principle.

IV. The Impact Ensign Tankers may have in Australia

To recap, the English courts have developed an anti-avoidance doctrine known as the *Ramsay* principle. At one point in the development of this doctrine, namely after *Dawson* and its restriction in *Craven* v. *White*, the High Court of Australia rejected the argument that this principle applied in Australia. This principle has now been developed further by the House of Lords in *Ensign Tankers* which, on the better view, confirmed that the *Ramsay* principle required the court to apply the tax legislation to the true legal effect of the transactions construed as a whole. *Ensign Tankers* further drew a distinction between 'tax avoidance' and 'tax mitigation' schemes but the preferred view is that this distinction is only instructive and does not restrict the *Ramsay* principle.

This part of the article considers whether, owing to the developments in *Ensign Tank-*

35 [1984] A.C. 474, 518.

36 He believes that despite the words of Lord Brightman in *Dawson*, quoted earlier, that *Dawson* was a case of 'tax avoidance', [1992] 2 All E.R. 275, 290-1.

ers, the revitalised *Ramsay* principle may now be applicable in Australia. For this to happen, *John's* case must be either overruled or distinguished. Because the first of these options is difficult to predict, the possible grounds for the second of these options will be considered. It is submitted that to distinguish *John's* case requires two findings. First, the actual decision made by the High Court on the facts of *John's* case must not preclude the operation of the *Ramsay* principle. Secondly, the legal basis for the *Ramsay* principle must be shown to be other than the legal basis assumed by the High Court in reaching their decision, i.e. it must be shown that the High Court misconstrued the legal basis of the *Ramsay* principle. The present discussion will first consider whether, *Curran* aside, the decision in *John's* case would have been different if the *Ramsay* principle was applied, in other words the correct legal basis of the *Ramsay* principle will be considered. Thirdly, consideration will be given to the application of the *Ramsay* principle in the United Kingdom where a general or specific anti-avoidance provision applies. This will assist in clarifying whether the *Ramsay* principle may be applied in parallel with, or as an alternative to, Part IV A of the *Income Tax Assessment Act* 1936. Fourthly, because we are considering the impact of *Ensign Tankers*, the question will be asked whether, if the *Ramsay* principle does apply in Australia, there are circumstances in which it may apply when either Part IV A is difficult to apply or does not apply.

(a) *Applying the Ramsay principle to the facts of John's case*

The question to be considered now is whether the decision in *John's* case would have been different if the *Ramsay* principle had applied. From a United Kingdom perspective, after looking at the transactions involved in *John's* case as a whole, the financial effect of the taxpayer's actions are clear, namely, there is a $1,165 profit. It will be recalled that this is exactly what the High Court found when it considered the transactions as a whole.[37] It is now useful to note a peculiar difference between the United Kingdom and the Australian tax systems.

The Australian tax system brings all 'assessable income' into account. This is *gross* income, which the taxpayer can reduce by claiming 'allowable deductions' under s.51. So prima facie, all assessable income is subject to income tax. This situation can be contrasted to the U.K. position where, under Schedule D Case I,[38] it is the *profits* of a trade which are prima facie subject to tax, i.e. the net profits after deductions. There is no general deducting provision in the U.K. income tax legislation. That expenses laid out in the conduct of a trade are deductible in calculating a taxpayer's *profits* is implied by the legislation. In contrast to Australia's s.51, the U.K. has a provision[39] which sets out what sums may *not* be deducted.

Holding that the true legal effect of the transaction was that the partnership bought the shareholding and sold it for a $1,165 profit does not assist the Commissioner because the Australian Act is not concerned with *profits* but with *assessable income*. Fundamental to the *Ramsay* principle is that the tax legislation must be applied to the true legal effect of the transactions. Under the Australian legislation this requires the court to make a finding with respect to two matters; first, the quantum of assessable income, and secondly, as to the quantum of deductions under s.51. This is the approach taken by the High Court in *John's* case:

1. What was the assessable income?

The High Court's answer to the first question was that the assessable income was equal to the sale price of all the shares. This finding cannot be faulted.

2. What were the allowable deductions?

37 See *supra* note 19 and text.
38 *Income and Corporations Taxes Act* 1988, s.18.
39 *Id.* s.74.

For the Commissioner to succeed through the application of the *Ramsay* principle the very nature of the transactions as construed under that principle must remove the tax advantage sought by Mrs John. The only way to negate the deduction available under *Curran* is if it can be successfully argued that the issue of the bonus shares can be ignored.

In *John's* case, the Commissioner actually attempted this argument under s.260. The High Court pointed out this would not eliminate the loss because:

> [I]t is necessary to take the further step of treating the original shares as having been sold at the price at which the original and the bonus shares were sold. That step involves a hypothetical reconstruction of the ... transactions. That is not ... authorised by s.260.[40]

How does the *Ramsay* principle apply to this argument? Clearly, with the *Dawson* extension the Commissioner may succeed and the transactions could be reconstructed. But without the extension we must ask whether the true legal effect of the parties' transactions enables the issue of the shares to be ignored. To answer this question 'yes' requires an affirmative answer to two other questions.

First, regarding the transactions as a whole, was their true legal effect that the consideration was received only for the original shares? It is submitted that the answer to this question may be 'yes' but depends on the outcome of the second question. The view that the consideration from the sale of the shareholding was only received for the original shares, accords with the High Court's reasoning in rejecting *Curran*. The High Court said that as the reduction in value to the original shares when the bonus shares were issued was not accounted for, then 'there is no basis for ascribing a value to the bonus shares for the purpose of calculating the profit or loss referrable to the ... transactions.'[41]

The second question is did the legal arrangements produce the bonus shares?[42] The answer must be yes, the company's capital has been permanently altered. The share register has been altered and a third party has purchased those shares and any rights attaching to them. If we cannot ignore the existence of the bonus shares, it is difficult to accept that no consideration was attached to them and therefore the answer to the second question affects the answer to the first question. It is likely benefits such as voting and rights to dividends and surplus on winding up attached to these shares, so they were not worthless. If this line of reasoning is correct then the true legal effect of the transactions was that the bonus shares were issued and the money attributed to them received for them which is exactly what the taxpayer contended.

If this reasoning is wrong, and the correct view under the first question is that all the consideration was received for the original shares and none for the bonus shares, the Commissioner would still not succeed under the *Ramsay* principle. This is because the dividend would still have been credited towards the bonus shares and therefore deductible under *Curran*. If the answer to the second question was that the bonus shares were non-existent, then unless all the consideration on sale is attributed to the original shares, the partnership will have made a large loss on those shares similar to the position under *Curran*. Therefore, an affirmative answer is required to both questions and it is submitted such a response is incorrect. Accordingly, the finding in *John's* case is not inconsistent with the *Ramsay* principle.

(b) *Did the High Court misconstrue the legal basis of the Ramsay principle?*

The High Court dealt with the *Ramsay* principle on the basis of Lord Brightman's formulation[43] and that the principle was a matter of statutory construction. It is now intended to consider whether the High Court misconstrued the *Ramsay* principle in determining that

40 (1988) 166 C.L.R. 421, 433.
41 *Id.* 440-441.
42 The application of s.44(2), as it then was, turns on this issue.
43 See *supra* note 13 and text.

it was a matter of statutory construction. First, the question will be addressed whether *Ensign Tankers* sheds any light on this issue. Secondly, as the *Ramsay* principle has been applied outside the area of taxation in the United Kingdom, an analogy will be drawn with a number of company charge cases in order to argue that the legal nature of the *Ramsay* principle is actually a matter of simple construction, not statutory construction. Thirdly, this analogy will be extended to Australian case-law in order to show that the interpretation of the *Ramsay* principle postulated here has been approved and applied in Australia outside the area of taxation law. Finally, the legal basis for the *Ramsay* principle will be summarised and analysed.

(i) What does Ensign Tankers have to say about the legal basis for the Ramsay principle?

Nowhere in the judgment of Lord Templeman in *Ensign Tankers* is there any reference to either Lord Brightman's formulation or the fact that the *Ramsay* principle is a matter of statutory construction. On the contrary, throughout his judgment Lord Templeman refers to 'viewing the *transactions* as a whole.'[44] It is submitted that this duty does not necessarily involve statutory construction.

(ii) Ramsay principle applied outside the area of taxation in the United Kingdom

The *Ramsay* principle has been expressly extended in the United Kingdom to private transactions outside the field of taxation.[45] In particular, a useful analogy can be drawn between the tax cases and some company charge cases. Where a company sells an asset in circumstances where, if the transactions are viewed as a whole, it is revealed that there is not in fact a sale at all but a charge on an asset of the company, that charge/sale may be void against a liquidator for want of registration under the relevant legislation. *Re Curtain Dream Plc*[46] was a case in which this principle was applied. A similar case, but where the parties' intentions were upheld, was *Welsh Development Agency* v. *Export Finance Co. Ltd.*[47] Dillion L.J. in the Court of Appeal said:

> [T]here is no one clear touchstone by which it can necessarily and inevitably be said that a document which is not a sham and which is expressed as a sale must necessarily as a matter of law, amount to no more than a mortgage or charge on the property expressed to be sold. ... look at the ... Agreement as a whole to decide whether in substance it is a sale or mortgage or charge.[48]

Note that it is not the legislation which is to be looked at but the *agreement*. This accords with the argument that the *Ramsay* principle is a simple matter of construction.

(iii) The Ramsay principle has been approved in Australia outside taxation

Extending the analogy referred to under the last sub-heading, there is Australian jurisprudence of the highest authority according with Lord Wilberforce's formulation of the *Ramsay* principle. *Palette Shoes Pty Ltd* v. *Krohn*[49] was concerned with whether an agreement was a sale or an assignment of book debts which required registration. In assessing the agreement, Dixon J. said:

> [I]t remains necessary to examine the true nature of the consequences it produces and to determine whether its legal operation, when properly understood, is of that description which falls under the necessity of registration as an assignment or transfer of book debts.[50]

If the *Ramsay* principle is viewed in this light then not only is it nothing new but it is

44 On no fewer than 16 occasions.
45 See discussion in *Welsh Development Agency* v. *Export Finance Co. Ltd* [1992] B.C.L.C. 148, 188.
46 [1990] B.C.L.C. 925.
47 [1992] B.C.L.C. 148.
48 *Id.* 161.
49 (1937) 58 C.L.R. 1.
50 *Id.* 28.

not so much based on statutory construction principles but simply construction principles. Contrast these words of Dixon J. with these of Lord Wilberforce in *Ramsay* itself:

> [T]he approach for which the Crown contends 'does not introduce a new principle; it would apply to new and sophisticated legal devices, the undoubted power and duty of the courts to determine their nature in law and to relate them to existing legislation'.[51]

(iv) So what is the legal basis for the Ramsay principle?

It is clear from the last quoted words of Lord Wilberforce that the first duty of the court is to ascertain the true legal effect of the parties' actions. Once this is done, the court must then apply the legislation to this finding. Only the second stage requires statutory construction and the application of statutory avoidance provisions. The Court of Appeal has held that the *Ramsay* principle is not so much a principle of statutory construction but one of statutory application.[52] To similar effect is the following passage from the judgment of Lord Keith in *Craven* v. *White*:

> [T]he court must first construe the relevant enactment in order to ascertain its meaning; it must then analyse the series of transactions in question, regarded as a whole, so as to ascertain its true effect in law; and finally it must apply the enactment as construed to the true effect of the series ... The most important feature of the principle is that the series of transactions is to be regarded as a whole.[53]

As was argued earlier, if this is all that is involved in the *Ramsay* principle then the formulations, such as Lord Brightman's or Lord Templeman's distinction between 'tax avoidance' and 'tax mitigation' amount to no more than guidelines on how best to ascertain the true legal effect of a series of transactions.

The High Court assumed that this was a 'new principle of (statutory) construction.'[54] However, the *Ramsay* principle is not a new principle. It is simply an application of the principle referred to by Dixon J. in the *Palette Shoes* case to a series of transactions. Even if it is a new principle, it is not a principle of *statutory* construction. Further, even if the *Ramsay* principle is an extension of the principle referred to by Dixon J. it is a desirable extension. As Lord Wilberforce said in *Ramsay*:

> To force the courts to adopt, in relation to closely integrated situations, a step by step, dissecting, approach which the parties themselves may have negated would be a denial rather than an affirmation of the true judicial process. In each case the facts must be established, and a legal analysis made; legislation cannot be required or even be desirable to enable the courts to arrive at a conclusion which corresponds with the parties' own intentions.[55]

(c) *Application of the Ramsay principle in the United Kingdom where a legislative provision is applicable*

In arguing that the High Court misconstrued the legal basis for the *Ramsay* principle and that the principle can apply despite an anti-avoidance provision, support can be obtained from the English cases. In *Countess Fitzwilliam* v. *I.R.C.*[56] it was held that the availability of an express provision in the *Inheritance Tax Act* (U.K.) did not exclude the *Ramsay* principle. It appears that the United Kingdom courts will allow the use of the principle as an alternative to, but not necessarily in parallel with, a specific anti-avoidance provision.[57] If the *Ramsay* principle is merely a question of construction, then presumably the true legal nature of a transaction should be ascertained before the court applies any spe-

51 [1982] A.C. 300, 326.
52 *Fitzwilliam* v. *I.R.C.* [1992] S.T.C. 185, 198.
53 [1989] A.C. 398, 479.
54 (1988) 166 C.L.R. 421, 435.
55 [1982] A.C. 300, 326.
56 [1992] S.T.C. 185.
57 *Bird* v. *I.R.C.* (1988) 61 T.C. 238, see comments of Lord Keith at 343.

cific or general anti-avoidance provision. This means the *Ramsay* principle would not apply as an alternative to, or in parallel with, such a provision but rather as a prelude to its application.

(d) *Applying Part IV A to the facts in Ensign Tankers*

There has been much concern in the legal profession in Australia over the operation of Part IV A. Where the provisions of the Part apply, the Commissioner may determine that an amount be included in a taxpayer's assessable income or that a deduction is not allowable.[58] Further, where the Commissioner has made a determination under Part IV A, the taxpayer is liable to additional tax of double the amount of tax that is payable by reason of the Commissioner's determination.[59] The object of the present discussion is to apply the provisions of Part IV A to the facts of *Ensign Tankers* in order to highlight the uncertainties of that Part. These uncertainties will be used to argue that, while a result under Part IV A cannot be readily predicted, the better view is that it is unlikely to produce the equitable decision which was reached in *Ensign Tankers* itself.

Part IV A applies where a taxpayer obtains a tax benefit in connection with a scheme and having regard to eight stated matters, it would be concluded that any person who entered into the scheme, or any part of the scheme, did so for the sole or dominant purpose of enabling the taxpayer to obtain a tax benefit in connection with the scheme. The discussion will consider first, whether *Ensign Tankers* involved a 'scheme', and secondly, whether the partnership in that case received a 'tax benefit'. Thirdly, consideration will be given to the eight matters to be accounted for in assessing whether the partnership, or Lorimar's sole or dominant purpose in entering the transactions, was to obtain a tax benefit for the partnership. Fourthly, consideration will also be given to some comments made by the Australian Treasurer as to the scope of the Part and whether his comments are consistent with the wording of the Part. Finally, assuming that Part IV A does apply to the facts of *Ensign Tankers*, the tax consequences of that application to the taxpayer will be examined.

(i) What 'scheme' did Ensign Tankers involve?

'Scheme' is defined in s.177A(1) in extremely wide terms, including such things as agreements, arrangements, understandings, proposals (whether enforceable or not) as well as courses of action and conduct. A difficult matter is determining exactly what the scheme is in relation to a transaction. For example, a formal agreement would constitute a scheme, but it is possible that the pre-contractual negotiations would amount to an informal arrangement and therefore also constitute a scheme. The facts of *Ensign Tankers* provide a clear example of this difficulty. On one view, the scheme may be the entire course of conduct of the parties in arranging the investment in the film. On another view, the scheme may be viewed as just the non-recourse loan agreement or just the transfer of the film rights.

On a wide view of the definition of 'scheme', both the investment in the film and parts of that investment constitute separate 'schemes'. On a narrow view, parts of a scheme cannot themselves constitute 'schemes' because they each form part of a larger 'scheme'. This latter view is supported by the specific wording of s.177D, the general provision which defines schemes to which Part IV A applies. This section applies the Part to a scheme where the sole or dominant purpose of entering into 'the scheme or *any part of the scheme*' was for the taxpayer to obtain a tax benefit. It is submitted that it is incorrect, or at least ambiguous, to refer to an agreement as a 'scheme' and 'part of a scheme' in the same breath. So, for example, it is incorrect to refer to the non-recourse loan as both a

58 See s.177F. In this area it should be noted that special leave has been granted to appeal to the High Court in the *Peabody Case* (1993) 25 A.T.R. 32.

59 See s.226(2A).

scheme and part of the investment scheme. If both the loan and the investment constitute schemes then potentially s.177D may be applied to the non-recourse loan twice, once as a scheme in itself and once as a 'part of a scheme'. If the legislature had intended that s.177D have this effect and potentially apply both to a 'scheme' and a 'scheme' within a 'scheme', then within the phrase quoted from s.177D above it should have included at the end of that phrase '(whether or not that part constitutes a scheme in itself or not)'. Further, in the definition of 'scheme' in s.177A there is no reference to 'part' of an agreement, course of conduct, etc. Further, interpreting the definition to exclude a scheme within a scheme promotes certainty. Instead of a particular course of conduct giving rise to any number of 'schemes', it can only give rise to one, i.e. the parent scheme. If the first mentioned wider view is accepted, then the tax consequence attaching under Part IV A to a transaction when viewed as a number of schemes may be different to the tax consequence attaching if the transaction was itself viewed as a scheme. This leads to unacceptable uncertainty and ambiguity. It is submitted that the better view of the facts of *Ensign Tankers* is that the investment in the film, and only the investment in the film, constituted a scheme.

(ii) What tax benefit was involved in Ensign Tankers?

Section 177C(1) is the provision which defines what is a 'tax benefit in connection with a scheme'. Here, s.177C(1)(b) is relevant to the facts of *Ensign Tankers*. It provides that an allowable deduction is a tax benefit in connection with a scheme where that deduction, or a part of it, would not have been allowable if the scheme was not entered into. Section 177C(1)(d) provides that the amount of the tax benefit is the whole of the deduction, or the part of it, as the case may be.

On the better view, that the investment in the film constituted the 'scheme', the 'tax benefit' is the entire first year allowance claimed, i.e. includes the \$3.25m allowed by the House of Lords. Where the 'scheme' is considered to be the non-recourse loan, there is no 'tax benefit' because it is the transfer of the film not the loan which gave rise to the first year allowance for the costs. Where the 'scheme' is constituted by the transfer of the film rights, the tax benefit is again the entire first year allowance claimed by the partnership.

(iii) Was the sole or dominant purpose to obtain the tax benefit?

Part IV A applies where a taxpayer has obtained a tax benefit in relation to a scheme and having regard to eight listed matters it would be concluded that any person entered the scheme, or any part of it, for the sole or dominant purpose of enabling the taxpayer to obtain a tax benefit in connection with the scheme (s.177D). Did the partnership or Lorimar enter the investment scheme for the sole or dominant purpose of enabling the partnership to obtain a tax benefit? It is useful to consider the eight matters listed in s.177D. From the evidence which appears in the report of *Ensign Tankers*, the following comments are submitted:

1. The scheme was entered into and carried out at arm's length on a commercial basis.
2. The form of the scheme was a 100% equity participation by the partnership. The substance of the scheme was that the partnership was at risk for approximately 25% of the costs and only entitled to 25% of the profits.
3. The scheme was carried out over a normal commercial period for the making of a film.
4. Without the operation of Part IV A, the partnership was entitled to deduct 100% of the costs of the film as a first year allowance.
5. The financial position of the partnership has changed as a result of the scheme by converting the expenditure of \$3.25m into a claim for a deduction of some \$14m plus assessable income in the form of 25% of the profits of the film.
6. Lorimar's financial position was altered by the introduction of \$3.25m to finance

the film, the loss of 25% of profits from the film and the loss of any right to claim a first year allowance.

7. The partnership has placed $3.25m at risk and Lorimar has reduced its exposure to the film by the same amount.
8. Lorimar owned the general partner of the partnership but was not connected with the limited partners.

There is no indication what weight should be accorded to any of these matters. Further, it appears that the subjective purpose of the persons in entering the scheme is irrelevant: s.177D embodies a wholly objective test.[60] From a consideration of the above eight matters (in particular, items 2, 4 and 8) it is objectively obvious that *a* purpose of both parties in entering into the scheme was that the partnership obtain a tax benefit. However, after regarding the eight matters, it is submitted that objectively, the agreement between Lorimar and the partnership was basically a commercial one. It cannot be said that the sole purpose of the parties in entering into the scheme was that the partnership obtain the tax benefit. But was it the dominant purpose?

It is submitted that when the whole investment scheme in *Ensign Tankers* is considered, regarding the eight matters, the better view is that the tax benefit was clearly not the dominant purpose. This was dominantly a commercial agreement between parties at arm's length which was implemented in a tax efficient way.

However, s.177D also refers to the dominant purpose of entering into any *part* of the scheme. So what was the purpose of the parties in entering into the non-recourse loan part of the scheme? This is a more difficult situation to analyse and it is useful to refer to the following words of Lord Donovan in delivering the judgment of the Privy Council with respect to the New Zealand general anti-avoidance provision:

> If a bona fide business transaction can be carried through in two ways, one involving less liability to tax than the other their Lordships do not think s.108 can properly be invoked to declare the transaction wholly or partly void merely because the way involving less tax is chosen. Indeed, in the case of a company, it may be the duty of the directors vis-à-vis their shareholders so to act.[61]

It was the duty of the directors of Ensign to protect the assets of the company. A non-recourse loan placed the company at far less risk than a conventional loan.

Consider the transfer of the film rights as part of the investment scheme. One of the purposes for entering into the transfer was to obtain the first year allowance. It is submitted this is clearly not the dominant purpose. The transfer was at the very heart of the scheme, i.e. the equity participation. Again, the transfer was a form of security for the company and was an integral part of the commercial agreement to invest in the film. The commerciality of this agreement is a paramount consideration in determining the parties' objective purpose in entering the scheme or any part of it. The facts show that Lorimar's bank wanted Lorimar to come up with an injection of funds to reduce the bank's risk. So the objective purpose of Lorimar in entering the transactions is clearly to satisfy the requirements of the bank. Similarly, Ensign's purpose was clearly to make money on a commercial investment. The directors of Ensign drove a hard bargain, minimising risk where they could and taking advantage of the tax break. If the directors had known that the House of Lords would reject their claim then no doubt they would have negotiated other terms, such as a greater profit participation, or not invested at all. It is submitted there is nothing in the eight matters to be considered which would objectively lead to the conclusion that the entire scheme, the non-recourse loan or the transfer of the film rights,

60 See comments in CCH *Australian Federal Tax Reporter*, para. 81-345.
61 *Mangin* v. *C.I.R.* 70 A.T.C. 6001, 6006.

were entered into by either party for the dominant purpose of the partnership obtaining a tax advantage.

What of the use of a limited partnership? This was clearly designed to protect the liability of Ensign, otherwise an ordinary partnership may have been used. To apply Part IV A, what is needed is to hone in on the excess $10m first year allowance. Where did it come from? It came from the transfer of the film rights, but not the complete transfer, only the excess 75% over the 'real' 25% investment. The *Ramsay* principle is not being used now, we are interpreting the parties' actions and agreement, not as a whole, but piece by piece. The agreement says nothing about 75%; it transfers the film rights whole. It is strongly submitted that it is incorrect to say an agreement to transfer 75% of a film is a *part* of an agreement to transfer the whole of the film. The result is that there is no *part* of the scheme which was entered into for the dominant purpose of the partnership obtaining a tax advantage.

In support of the above argument, it is useful to quote from another Privy Council decision on the New Zealand anti-avoidance provision. In *Europa Oil (N.Z.) Ltd. (No.2)* v. *C.I.R.*[62] Lord Diplock said:

> [Section 108] does not strike down ordinary business or commercial transactions which incidentally result in some saving of tax. There may be different ways of carrying out such transactions. They will not be struck down if the method chosen for carrying them out involves the payment of less tax than would be payable if another method was followed. In such a case the avoidance of tax will be incidental to and not the main purpose of the transaction ... which will be the achievement of some business or commercial object.

Where a scheme forms parts of a larger scheme, are the circumstances and context of that larger scheme to be accounted for in assessing the smaller scheme? If the larger context can be considered, then arguably the application of s.177D to the smaller scheme is no different than if that section had been applied to it as *part* of the larger scheme. This view derives some support from a decision of the House of Lords.[63] It also draws support from s.177D(b)(i) which requires regard to be given to the manner in which the (smaller) scheme was entered into. This clearly requires a consideration of the larger scheme. The better view is s.177D would not be applied differently if the non-recourse loan or the transfer of the film rights were considered separate schemes and not just as parts of the larger investment scheme.

(iv) Comments of the Treasurer

The Treasurer has made some comments which support the view of the present writer that Part IV A does not apply to the facts of *Ensign Tankers*. First, in his Second Reading Speech he said that Part IV A embodied the test of the Privy Council in *Newton* v. *F.C.T.*[64] and therefore the new provisions were inapplicable to schemes entered into in the course of ordinary business. Without judicial comment, it is difficult to assess whether this view is correct. Secondly, in his Second Reading Speech the Treasurer said:

> [T]axpayers who simply take advantage of concessions for the purposes for which they were put in the law cannot and will not be affected by the new provisions. Specifically ... Part IV A will not deny people who respond to our concessions for investment in Australian films the benefit of the tax advantages that are part of those concessions.

The words of the Treasurer can be criticised because, as the above discussion has shown, taking advantage of such a concession clearly involves a scheme and a tax benefit. The only issue is whether the scheme was entered into for the dominant purpose of obtaining the tax benefit. If taken literally, the words of the Treasurer suggest that even if

62 76 A.T.C. 6001, 6009.
63 *I.R.C.* v. *Brebner* (1967) 43 T.C. 705 per Lord Pearce.
64 [1958] A.C. 450, followed in *Europa Oil (N.Z.) Ltd. (No.2)* v. *C.I.R.* 76 A.T.C. 6001, 6009.

that was the parties' dominant purpose, they would still be outside Part IV A. The better view of the Treasurer's words is that because most tax concessions are aimed at investment by people in the conduct of their business, Part IV A would not apply to participation in a scheme aimed at such a concession because of the Treasurer's view mentioned earlier, namely, that the Part does not apply to schemes entered into in the ordinary course of business as the transactions will always be entered into for the commercial purpose. The Treasurer's views add weight to the argument that Part IV A does not apply to the facts of Ensign Tankers.

(v) Effect if Part IV A did apply

The penalty provision in s.226(2A) has already been mentioned. S.177F(1) provides that where Part IV A applies, the Commissioner may determine that the tax benefit referrable to a deduction or a part of a deduction shall not be allowable. Therefore, if the Commissioner does make such a determination, it is a prima facie the whole tax benefit which will be disallowed as a deduction. This is subject to the Commissioner's power under s.177F(3) to adjust the amount in favour of the taxpayer if he considers it fair and reasonable. If this section was applied to the whole investment scheme in *Ensign Tankers* the entire first year allowance, including the $3.25m actually expended, is liable to be struck down. The equitable result provided by the *Ensign Tankers* decision could only be achieved by relying on the Commissioner's power in s.177F(3).

(e) *Conclusion*

It has been argued that, in light of the decision of the House of Lords in *Ensign Tankers*, the High Court in *John's* case misconstrued the legal basis for the *Ramsay* principle. This leaves it open for a future Australian decision to distinguish *John's* case and apply the revitalised *Ramsay* principle (preferably without the *Dawson* extension). This paper has also sought to highlight the uncertainties and ambiguities faced in applying the provisions of Part IV A by attempting to apply those provisions to the facts of *Ensign Tankers*. The decision of the House of Lords in *Ensign Tankers* was clear, certain and simple to understand. The partnership only expended $3.25m, so it was only entitled to that much first year allowance. Contrast the mess which results from an application of Part IV A. The reason for this contrast is clear: the English approach refuses to get bogged down in the technicalities the parties have created to avoid tax. The Australian approach appears to accept these technicalities and then tries to apply an extraordinarily wide and uncertain anti-avoidance provision to them. Under the English approach, the court takes time to perform its undoubted duty to proclaim the legal effect of the parties' actions before applying the tax statute.

It is disappointing that the High Court did not consider the *Ramsay* principle in more depth in *John's* case. More disappointing is that *Ensign Tankers* was decided after *John's* case because the High Court may well have considered it appropriate to approve the *Ramsay* principle without the *Dawson* extension. However, when it is considered that in *John's* case the High Court saw fit to overrule its own decision in *Curran*, it may not be such a great step for that Court to distinguish *John's* case as a rejection of the *Dawson* extension, leaving room for the *Ramsay* principle to again rear its head in Australia.