

## Interpreting Taxing Statutes # 40 – Tax avoidance, the Westminster principle and the Ramsay approach

A person is entitled to order their affairs in the most tax-efficient way (Westminster principle). However, the court will look closely at any transaction entered into for the purposes of avoiding tax. In particular, it will construe the enactments in question purposively and will view the facts of the transaction realistically. A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually.<sup>1</sup>

### SYNOPSIS

Distinction between tax evasion and tax avoidance

- Tax planning

The Westminster principle

- IRC v Duke of Westminster
- Method of ordering

The Ramsay Approach

- Principles of statutory construction
- Transaction with no commercial purpose

### Distinction between tax evasion and tax avoidance

In the tax field, the term “evasion” trends to be reserved for dishonest activities, whilst “avoidance” is used for activities aimed at avoiding a tax charge (whether or not the avoidance is successful).<sup>2</sup>

**Tax planning:** The term “tax mitigation” (or “tax planning”) is used to describe the ordering of a person’s affairs in the most tax-efficient way. In the tax field, professionals devise elaborate

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<sup>1</sup> Bennion 2020 s 12.12

<sup>2</sup> Bennion 2020 p 467

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schemes intended to allow taxpayers to escape tax. When this happens on a large scale in relation to a particular charging enactment it may lead to the inclusions of provisions in a Finance Act, intended to counter that avoidance. The experts then seek to devise always round the provisions, and so chase goes on.<sup>3</sup>

### **The Westminster principle**

It is quite often the case that a transaction can be structured in different ways that produce a similar commercial result but different tax consequences. In such cases, a person is entitled to order their affairs in the most tax-efficient way.

**IRC v Duke of Westminster:** In IRC v Duke of Westminster (1963) AC 1 the House of Lords laid down the principle that if a transaction is genuine the courts cannot go behinds it to some supposed underlying ‘substance’ Lord Tomlin said:

“Every man is entitled, if he can, to order his affairs so that tax attaching under appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the commissioners of Inland Revenue or his fellow taxpayer may be of his ingenuity, he cannot be compelled to pay an increased tax. The so-called doctrine of ‘the substance’ seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.”

**Method of ordering:** The Westminster principle still applies in many cases, and was described in the Ramsay decision<sup>4</sup> as “cardinal”. However, Lord Tomlin’s observations in the Westminster case tell us little or nothing as to what method of

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<sup>3</sup> Bennion 2020 p 467

<sup>4</sup> W T Ramsay Ltd v Inland Revenue Commissioners (1982) AC 300

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 ordering one's affairs will be recognised by the courts as effective to lessen the tax that would otherwise be payable.<sup>5</sup>

### **The Ramsay approach**

The courts have developed their approach to the construction of tax legislation over the years, on account of the fact that much effort is expended in attempt to avoid paying tax. Where taxpayers will be taxed differently on two kinds of transaction that produce economically equivalent results, they have an incentive to enter into the kind of transaction that results into a lower tax bill. Depending on the factual situation, this may be regarded as perfectly accepted tax planning, or it may be regarded as illegitimate tax avoidance (particularly where one kind of transaction, producing a lower tax bill, appears to be disguised from the other kind of transaction). Similar issues may arise where a particular kind of transaction give a taxpayer a benefit (for example, an allowance or an allowable loss). Here, a taxpayer may make efforts to obtain that benefit even though the taxpayer is not undertaking the kind of transaction that the legislature had in mind when deciding to give taxpayers that benefit. Clearly, the courts cannot simply apply the 'elephant test' (ie a test which is difficult to describe, and is based on knowing it when you see it).<sup>6</sup>

**W T Ramsay Ltd v Inland Revenue Commissioners:** In this backdrop, a general principle of statutory construction was enunciated in *W T Ramsay Ltd v Inland Revenue Commissioners* (1982) AC 300. The principle is twofold:

(a) To decide on a purposive construction exactly what transaction will answer to the statutory description; and

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<sup>5</sup> *Inland Revenue Commissioners v Burnmah Oil Co Ltd.* (1981) 54 TC 200

(b) To decide whether the transaction in question does so.<sup>7</sup>

It does not matter in which order these two steps are taken; and it may be that the whole process is an iterative process.<sup>8</sup>

**Principles of statutory construction:** In the later cases the Ramsay approach was further crystallized and the following principles of statutory construction were laid down:<sup>9</sup>

(i) Although the interpreter should assume that a statutory provision has some purpose, the purpose must be found in the words of statute itself. The court must not infer a purpose without a proper foundation for doing so.

(ii) In seeking the purpose of a statutory provision, the interpreter is not confined to a literal interpretation of the words, but must have regard to the context and scheme of the relevant Act as a whole.

(iii) The more comprehensively Parliament sets out the scope of a statutory provision or description, the less room there will be for an appeal to a purpose which is not literal meaning of the words.

(iv) In looking at particular words that Parliament uses what the interpreter is looking for is the relevant fiscal concept.

(v) Although one cannot classify all concepts a priori as “commercial” or “legal” it is not an unreasonable generalisation to say that if Parliament refers to some commercial concept such as gain or loss it is likely to mean a real gain or real loss rather

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<sup>6</sup> Bennion 2020 p 468

<sup>7</sup> Bennion 2020 p 468

<sup>8</sup> Bennion 2020 p 469

<sup>9</sup> *Berry v Commissioner for HM Revenue and Customs* [2011] UKUT 81 cited in Bennion 2020 p 468-470

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than one that is illusory in the sense of not changing the overall economic position of the parties to a transaction.

(vi) A provision granting relief from tax is generally (though not universally) to be taken to refer to transaction undertaken for a commercial purpose and not solely for the purpose of complying with the statutory requirements of tax relief. However, even if a transaction is carried out in order to avoid tax it may still be one that answers the statutory description. In other word, tax avoidance schemes sometimes work.

(vii) In approaching the factual questions whether the transaction in questions answers the statutory description the fact must be viewed realistically.

(viii) A realistic view of the facts includes looking at the overall effect of a composite transaction, rather than considering each step individually.

(ix) A series of transaction may be viewed as a composite transaction where the series of transactions is accepted to be carried through as a whole, either because there is an obligation to do so, or because there is an expectation that they will be carried through as a whole and no likelihood in practice that they will not.

(x) In considering the facts the fact-finding tribunal should not be distracted by any peripheral steps inserted by the actors that are in fact irrelevant to the way in which the scheme was intended to operate.

(xi) In considering whether there is no practical likelihood that the whole series of transaction will be carried out, it is legitimate to ignore commercially irrelevant contingencies and to consider it without regard to the possibility that, contrary to the intention

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and expectation of the of the parties it might not work as planned. Even if the contingency is a real commercial possibility, it may be disregarded if the parties proceeded on the basis that is should be disregarded.

**Transaction with no commercial purpose:** with Although the court is entitled to look at the overall effect of composite transactions, that does not mean that any transaction which has no commercial purpose is to be disregarded. Said as follows:

“The need to focus carefully upon the particular statutory provision and to identify its requirements before one can decided whether circular payments or elements inserted for the purpose of tax avoidance should be disregarded or treated as irrelevant for the purposes of the statute.”<sup>10</sup>

**Non-tax cases:** The Ramsay approach is a general principle of statutory construction. It is accordingly capable of being applied in non-tax cases. Said as follows:

“But precisely because the Ramsay principle is one of potentially general application, it has rightly not been suggested on either side that the [non domestic rates]- avoidance scheme into which the defendants entered are, by reason of their subject matter alone, immune from application of the principle.”<sup>11</sup>

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<sup>10</sup> Barclays Mercantile Business Finance Ltd v Mawson (2004) UKHL 51 cited in Bennion 2020 p 471

<sup>11</sup> Rossendale Borough Council v Hurstwood Properties (A) Ltd: (2019) EWCA Civ 364 cited in Bennion 2020 p 472