HIGH COURT OF JUSTICE (CHANCERY DIVISION)— A

COATES *v.* ARNDALE PROPERTIES LTD.—11, 12 AND 24 MARCH 1982(1)
REED *v.* NOVA SECURITIES LTD.—29 JULY 1982(2)

COURT OF APPEAL—

COATES *v.* ARNDALE PROPERTIES LTD. AND REED *v.* NOVA SECURITIES LTD.—
24, 25, 26, 27, 28 AND 31 OCTOBER 1983 AND 6 DECEMBER 1983 B

HOUSE OF LORDS—

COATES *v.* ARNDALE PROPERTIES LTD.—2 AND 3 OCTOBER
AND 22 NOVEMBER 1984
REED *v.* NOVA SECURITIES LTD.—3 AND 4 OCTOBER AND 29 NOVEMBER 1984
AND 31 JANUARY 1985 C

Coates (H.M. Inspector of Taxes) *v.* Arndale Properties Ltd.(1)
Reed (H.M. Inspector of Taxes) *v.* Nova Securities Ltd.(2)

Corporation tax—Group relief—Trading stock—Whether assets acquired as trading stock by one group company from another—Whether prospective capital loss effectively transmuted into a trading loss available for group relief— Income and Corporation Taxes Act 1970, *ss* 273, 274(1)—*Finance Act* 1965, *Sch* 7 *para* 1(1) *and* (3). D

In the first case the Company, a property dealer, acquired the lease of a development property from SPI, a property development company in the same group, for £3,090,000, and immediately sold it on to APT, an investment company in the same group, for £3,100,000, its then market value. SPI's outlay on the lease had been £5,313,822. E

In the second case the Company's parent company, as a result of an unsuccessful venture, owned the shares in and had very large debts due to it from an insolvent German subsidiary. The company, a dealer in shares and securities, bought the shares and some of the debts (nominal value DM 18 million) from its parent for £30,000, of which £29,990 was allocated to the debts and £10 to the shares. At the time the prospects were that the debts might produce £55,000 but on an uncertain date. F

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(1) Reported (Ch D) [1982] STC 573; 126 SJ 382; (CA) [1984] 1 WLR 537; [1984] STC 124; 128 SJ 224; (HL) [1984] 1 WLR 1328; [1985] 1 All ER 15; [1984] STC 637; 128 SJ 839.

(2) (Ch D) [1982] STC 724; (CA) [1984] 1 WLR 537; [1984] STC 124; 128 SJ 224; (HL) [1985] 1 WLR 193; [1985] 1 All ER 686; [1985] STC 124; 129 SJ 116.

Under s 273 of the Income and Corporation Taxes Act 1970, both companies would fall to be treated as having acquired the assets which they respectively acquired, not for the price which they paid, but at a value which would have produced neither a gain nor a loss to the vendor company. If, however, they acquired the assets "as trading stock" of their trades, as they contended they did, s 274(1) would apply. They would then be treated for purposes of para 1 of Sch 7 to the Finance Act 1965, as having acquired the assets otherwise than as trading stock and to have immediately appropriated them for the purposes of their trades as trading stock. Each company would thus have been treated as having made a capital loss and the assets would have been brought into their trading account at market value. However, they might alternatively make an election under para 1(3) of Sch 7, as each of them in fact did. No capital loss would then accrue but the companies' trading profits would then be computed on the basis that the assets would be brought into their trading account at their market value increased by the capital loss which would have accrued but for the elections. The trading loss to each company thereby resulting could then be surrendered by way of group relief to other members of their groups.

Assessments to corporation tax were made on the two companies. The assessments took no account of the losses on the footing that the relevant acquisitions of assets were for fiscal purposes only and that this fact prevented their being acquired "as trading stock" within s 274(1).

On appeals by the companies the General Commissioners found in the first case that the company's purchase of the property and its subsequent sale was a proper transaction in the course of the company's trade and in the second that the assets were acquired in the course of the company's trading and as trading stock. They determined the assessments accordingly. The Crown appealed.

The Crown's appeals to the Chancery Division were dismissed. In both cases the facts thought to be relevant by the parties had been agreed at the hearings before the Commissioners. On appeals by the Crown to the Court of Appeal it was conceded on behalf of the company in the first case that it had always been accepted that:

> "The officers responsible for overall group policy ... decided that the property should be sold to the company and immediately resold solely in order that the group should obtain a fiscal advantage in the form of tax relief for the large and genuine loss which SPI had suffered."

The Court of Appeal, unanimously allowed the appeal in the first case but by a majority (Fox and Kerr L.JJ., Lawton L.J. dissenting) dismissing that in the second.

The Company appealed in the first case and the Crown in the second. The two appeals were arranged to be heard one after the other, but when the Crown's appeal came on their Lordships indicated that there might be a difference between the position of the debts and that of the shares and requested further agreement on the debts at a subsequent hearing.

Held, in the House of Lords, in the first case dismissing the Company's appeal, that the Company followed instructions and lent to the transaction its name and its description as a property dealing company, but it did not trade and never had any intention of trading with

the lease. It accordingly did not acquire it "as trading stock", so as to be entitled to elect under para 1(3) of Sch 7. A

Per Lord Templeman[1]

"In these circumstances it is unnecessary to consider the application of the principles... in *Inland Revenue Commissioners* v. *Burmah Oil Co. Ltd.*[2] [1982] S.T.C. 30 and *Furniss* v. *Dawson*[3] [1984] A.C. 474 to a case where the legislature has made express provision for the mitigation of tax by the conversion of a capital loss into a trading loss provided certain conditions are fulfilled. It is also unnecessary to consider whether the dividend-stripping cases since 1963 have finally stripped the decision in *Griffiths* v. *J.P. Harrison (Watford) Ltd.*[4] [1963] A.C. 1 of its value to the tax-avoider". B

Held, in the second case, allowing the Crown's appeal in part, that: C

(1) property can only be acquired "as trading stock" for the purposes of s 274(1) if it is acquired for the purpose of being used in the course of trade;

(2) it could not be said on the evidence that no reasonable tribunal properly instructed could have decided that the debts were acquired as trading stock, since the Company conceivably might have hoped to make a profit on them by awaiting their realisation or by resale, but D

(3) since the shares were worthless and there was no commercial justification and no conceivable reason other than s 274 for their acquisition no reasonable tribunal could have concluded that they were acquired "as trading stock". It did not follow from the fact that they might have been acquired together with the debts as part of a package that they were also acquired as trading stock. E

Per Lord Bridge. The Revenue allowed the case to proceed before the Commissioners on an exiguous agreed statement of facts. In the result the Revenue had only themselves to blame that, so far as the debts are concerned, neither of the lower courts nor their Lordships felt able to interfere with the inference which the Commissioners drew from the facts so agreed.

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(1) COATES *v.* ARNDALE PROPERTIES LTD.

CASE

Stated under s 56 of the Taxes Management Act 1970, by the Commissioners for the General Purposes of the Income Tax for the Division of St. James, Westminster.

1. At an Appeal meeting held on 8 September 1980 We the General Commissioners for the Division of St. James, Westminster, heard the Appeal of Arndale Properties Ltd. against an assessment to corporation tax in the sum of £28,072 for the year ending 31 March 1974. The Respondent company was G

(1) [1984] 1 WLR 1328; at p 1333. (2) 54 TC 200. (3) 55 TC 324.
(4) 40 TC 281.

A represented by Mr. Wisely of Messrs. Binder Hamlyn & Co., and the Appellant Inspector of Taxes by Mr. A.A. MacKeith of the Inland Revenue.

2. The facts relating to this Appeal were agreed. A statement of agreed facts and four agreed documents, which are listed below are annexed to this case and form part of it.

(i) An assignment between Sovereign Properties (Newport) Ltd. to
B Arndale Properties Ltd. dated 30 March 1973 of a lease of the Kingsway Centre Newport Monmouthshire.

(ii) An assignment by Arndale Properties Ltd. to Arndale Property Trust Ltd. of the same lease on the same date.

(iii) The accounts of Arndale Properties Ltd. for the year ending 31 March 1973.

C (iv) A copy of a supporting statement with the accounts of Arndale Properties Ltd. for the year ending 31 March 1973 relating to the property transactions and current assets held by Arndale Properties Ltd. as at 31 march 1973.

Mr. Wisely told us that within the group there was a subsidiary company that acted as a banker to the parent company and its subsidiaries and the
D payment of cash in respect of the transaction between the three subsidiaries companies was made by book entries by the banking subsidiary. This was not challenged by the Inland Revenue.

No reason was given to us in evidence as to why the transactions took place in the manner in which they did and there was no other evidence.

3. The legal consequences so far as they relate to the incidence of
E corporation tax on the transactions are set out in para 2(a), (b) and (c) and paras 3 and 4 of the statement of agreed facts, so the only question for our determination was whether the Arndale Centre, Newport, was acquired by the Respondent company as trading stock.

4. It was contended on behalf of the Respondent company:

(i) The property had been acquired as trading stock and this was
F supported by the accounting treatment in relation to the purchase and sale of the property.

(ii) The definition of trading stock for the purposes of s 137 of the Income and Corporation Taxes Act 1970 defines it as being "property such as is sold in the ordinary course of trade". It was contended that the property in question was property such as the company sold in the ordinary course of its
G trade.

(iii) The property was, in fact, sold by the company and had not been held as an investment.

5. It was contended on behalf of the Inland Revenue that the Arndale Centre, Newport was not acquired by the Respondent company as trading stock.

H 6. In the further reply that was made on behalf of the Respondent company, it was contended:

(i) The Gurneville Securities case was decided on its own special facts, and in particular by looking at the transactions as a whole. A

(ii) A mistake had been made in the conveyance of the property from Sovereign Property Investments (Newport) Ltd. to Arndale Properties Ltd., but the true intention of the parties was reflected in the accounts.

(iii) At the time these transactions took place, bank accounts would have been held by only one company in the Town and City group, and the other companies in the group would not have had bank accounts. The price for these transactions would, therefore, be reflected in the current accounts which these companies had with that company in the group which was the banker company. B

7. We were referred to only one authority—*Thompson* v. *Gurneville Securities Ltd.* 47 TC 670. C

8. When we announced our decision we gave no reasons for it but we give them now.

(i) Arndale Properties Ltd. was an established trading company which had been incorporated at least prior to 31 March 1971 and exhibit 4 shows that it has in the past purchased properties for its trading stock from Arndale Property Trust Ltd. and there were at least two transactions other than the one the subject of this Appeal in which Arndale Property Trust Ltd. had disposed of properties in the course of business to Arndale Properties Ltd. There was therefore as a matter of fact evidence before us that Arndale Properties Ltd. acted as a property dealing firm within the group buying and selling properties from and to associated or subsidiary companies for the purpose of its business. D

(ii) On behalf of the Inland Revenue it was argued that the transactions were not transactions in the normal course of business and consequently Arndale Properties Ltd. was not entitled to take advantage of the election under Sch 7 para 1(3) of the Finance Act 1965 allowing it to take into account any losses sustained at the date it was appropriated to trading stock. In support of his contention the Appellant Inspector refers to the case of *Thompson* v. *Gurneville Securities Ltd.* (47 TC 670) where on complicated facts of that particular case The House of Lords held that the Appellant company was not a trader in the shares of the particular company. E F

(iii) In the appeal before us we have a subsidiary company A selling a property at market value, a fact which was not disputed, to subsidiary B who in turn sold it on to subsidiary company C. It is difficult to see what objection can be taken to these transactions at market value as the two transactions are within the normal course of business of each of the three subsidiary companies. G

(iv) The objection of the Appellant Inspector of Taxes to the transaction lies in that under s 273(1) of the Income and Corporation Taxes Act 1970 for the purposes of taxation the assignment of the lease from Sovereign Properties (Newport) Ltd. to Arndale Properties Ltd. is deemed to have been made on the basis that the consideration produces neither a gain nor the loss to the former i.e. the cost price of the development £5,313,822. H

(v) Statutory provisions also dictate that Arndale Properties must appropriate the asset of its trading stock under s 274(1) of the Income and

Corporation Taxes Act 1970 at market value which was in fact the price at which it purchased the property from Sovereign Properties Trust (Newport) Ltd.

As the result of the statutory deemed acquisition cost of the development by Arndale Properties Ltd. the company was entitled to the election under Sch 7 para 1 of the Finance Act 1965 allowing it to claim the difference between the market value at which the property was acquired and the deemed acquisition cost under s 273(1) as a trading loss. Had the sale by Sovereign Property Investments (Newport) Ltd. been to a third party instead of to a fellow subsidiary a loss arising on the sale of the property would presumably have been available to Sovereign Property Investments (Newport) Ltd. when it came to computing its corporation tax liability. The sale to Arndale Properties Ltd. at market value gives rise to a loss of £2,213,822 only because of the deemed purchase price under the Income and Corporation Taxes Act 1970 is the cost price.

It cannot be said that Sovereign Property Investments (Newport) Ltd. is not acting in the course of its business disposing of the investment to Arndale Properties Ltd. nor can Arndale Properties be said not to be acting in the course of its business by acquiring the property at market value. Nor can it be argued that the consideration of £3,100,000 is in excess of the financial resources of Arndale Properties Ltd. having regard to the evidence given to us that there was a Banking Subsidiary of Town and Country Properties Ltd. who acted as a bankers for the group. No doubt had the transaction been carried out with the assistance of finance from a Joint Stock Bank, such facility would have been available through the parent company.

(vi) A further argument put forward by the Appellant Inspector of Taxes was that while the company's accounts (exhibit 4) show the acquisition price as £3,090,000 and the sale on to Arndale Property Trust Ltd. as £3,100,000 the profit of £10,000 seems to have been of so little importance to the Respondent company that it was not provided for in the two assignments exhibits 1 and 2 where the consideration in both cases was shown as £3,100,000. We do not consider that this discrepancy which we were informed by Mr. Wiseley was an error can by itself make the transaction not one in the normal course of business of Arndale Properties Ltd. and we do not doubt that the accounts of Arndale Properties Ltd. show the true financial position. The Appellant would appear to have accepted the accounts as the proper basis of calculating the loss available to group relief which would on the face of the documents exhibits 1 and 2 otherwise have increased the loss available by £10,000. It has been recognised judicially that a taxpayer is entitled so to arrange his affairs as to reduce or minimise the incidence of tax although it is recognised that artificial transactions not in the normal nature of the company's business do not entitle the taxpayer to take advantage of the allowances granted by the statutory provisions. Here we have a company disposing of an asset at market value to a fellow subsidiary who was regarded by the Inland Revenue as a property dealing company who in the course of its business passed it on to a third subsidiary company in the group making a profit of £10,000 on which tax has been charged. There was no evidence to indicate that the transaction was other than one in the normal course of business of the company.

9. We accordingly found:

Having considered the agreed statement of facts and heard the arguments on behalf of the company and the Inland Revenue we find as a matter of fact

that the purchase by the company and its subsequent sale of the Arndale Centre Newport was a proper transaction in the course of the company's trade and we accordingly discharged the assessment.

10. The question for the opinion of the Court is whether our decision that the purchase by Arndale Properties and its subsequent sale was a proper transaction in the course of the company's trade was justified on the evidence before us.

17 July 1981

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(2) REED *v.* NOVA SECURITIES LTD.

CASE

Stated under the Taxes Management Act 1970, s 56 by the Commissioners for the General Purposes of the Income Tax for the Division of Holborn/ London for the Opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the General Purposes of the Income Tax for the Division of Holborn in the County of Greater London held on 21 October 1980 Nova Securities Ltd. (hereinafter called "Nova") appealed against an Assessment to corporation tax for the accounting period 6 April 1973 to 31 December 1973 in the sum of £850.

2. The question for our determination briefly stated was whether Nova acquired the assets described in para 6 of the Agreed Statement of Facts on 17 August 1973 as trading stock. It was agreed between the parties that if it was found that Nova did so acquire such assets as trading stock, the effect of ss 273 and 274 Income and Corporation Taxes Act 1970 and the election under para 1(3) of Sch 7 Finance Act 1965 referred to in para 12 of the Agreed Statement of Facts would be that in computing the profits or losses of Nova's trade for the purposes of corporation tax the market value of the assets acquired on 17 August 1973 would fall to be treated as increased at that date by £3,906,765 being the amount which would have been the amount of the allowable loss accruing to Nova under para 1(1) of Sch 7 Finance Act 1965 had no such election been made. The result would be that Nova would be treated as having incurred a trading loss of £3,906,765 from those transactions. It was agreed between the parties that Nova had made profits of £850 from other transactions during the relevant accounting period, which profit would be eliminated by the said loss leaving an unabsorbed loss of £3,905,915.

3. Mr. C.N. Beattie, Q.C. with Mr. C.J.F. Sokol instructed by Messrs. Allen & Overy appeared before us on behalf of the Respondent. Mr. A.A. MacKeith of the Solicitor's Office of the CIR appeared on behalf of the Appellant.

4. An Agreed Statement of Facts and an Agreed Bundle of exhibits number 1 to 10 (vii) were admitted before us and there was no other evidence. These are now appended to this Case and form part of it marked exhibit "A"(1).

5. It was contended on behalf of Nova that the assets were acquired as trading stock.

6. It was contended on behalf of the Appellant that the assets were not acquired as trading stock.

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(1) The agreed statement of facts is set out at page 549C post.

7. We were referred to the following authorities: *Harrison (Watford) Ltd.* v. *Griffiths* 40 TC 281; *CIR* v. *Kleinwort Benson Ltd.* 45 TC 369; *Lupton* v. *FA & AB Ltd.* 47 TC 580; *Thomson* v. *Gurneville Securities Ltd.* 47 TC 633.

8. We, the Commissioners who heard the appeal carefully considered the Agreed Statement of Facts and Bundle of exhibits and the submissions to us on behalf of the Appellant and Respondent.

We decided as follows:

We find as facts that the share capital and debts of Medallion as set out in para 6 of the Agreed Statement of Facts were acquired by Nova Securities Ltd. in the course of their trading in shares and securities and that they were acquired as trading stock. Accordingly we allow the Appeal and determine the assessment as profits £850 less losses £850 on the Assessment as raised.

9. The Appellant immediately after determination of the appeal declared to us through his representative his dissatisfaction therewith as being erroneous in point of law and required us to state a Case for the Opinion of the High Court pursuant to s 56 of the Taxes Management Act 1970 which Case we have stated and do sign accordingly.

10. The question of law for the Opinion of the High Court is whether our decision was justified on the evidence before us.

10 March 1981

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(1) COATES *v.* ARNDALE PROPERTIES LTD.

The case was heard in the Chancery Division before Goulding J. on 11 and 12 March 1982 when judgment was reserved. On 24 march 1982 judgment was given against the Crown, with costs.

A. Park Q.C. and *M. Flesch* for the Company.

J. Mummery for the Crown.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Edwards* v. *Bairstow* 36 TC 207; [1956] AC 14; *Ransom* v. *Higgs* 50 TC 1; [1974] 1 WLR 1594; *Floor* v. *Davis* [1978] STC 436; 52 TC 609; *Furniss* v. *Dawson* 55 TC 324; [1982] STC 267.

COATES v. *ARNDALE PROPERTIES LTD.*

Goulding J.:—This is an appeal by the Crown from a decision of the General Commissioners for the Division of St. James's, Westminster, upon an appeal by Arndale Properties Ltd., whom I shall call "the taxpayer", against an assessment to corporation tax for the year ending 31 March 1974. The facts are short and simple. When the case was opened I thought that the question to which they gave rise was likewise short and simple, but because of a number of relevant decisions by the House of Lords I am now of opinion that it is a difficult question.

The Income and Corporation Taxes Act 1970, contains special provisions relating to groups of companies. The taxpayer was at the relevant times a member of a group for the purposes of that Act. At the head of the group was a company called Town & City Properties Ltd. Among the subordinate members were Sovereign Property Investments (Newport) Ltd., whom I shall call "SPI"; the taxpayer; and the Arndale Property Trust Ltd., whom I shall call "APT". SPI was a company engaged in the development of landed property, the taxpayer was a property dealing company, and APT was an investment company. SPI acquired a leasehold property at Newport in Gwent, and by 30 March 1973, had laid out £5,313,822 on the acquisition and development thereof. At that date, however, the market value of the property was only £3,100,000. The property having been developed, those who controlled the companies evidently wished it to pass from the ownership of SPI to that of APT. On 30 March 1973, SPI assigned the property to the taxpayer for a consideration stated in the deed of assignment to be £3,100,000 but now agreed to have been in fact only £3,090,000. On the same day the taxpayer assigned the property to APT for £3,100,000, thus making a profit of £10,000. It is obvious, and is not disputed, that these two assignments were part of one and the same scheme. I shall refer to them together as "the transaction". It is also not disputed that the only motive of the companies concerned for engaging in the transaction, instead of a direct assignment from SPI to APT, was the expectation that favourable consequences would ensue to one or more of the companies in the group in relation to corporation tax. It was to work in this way. Under s 273(1) of the Income and Corporation Taxes Act 1970, the property disposed of by SPI to the taxpayer, they being members of the same group of companies, is treated for corporation tax purposes as acquired by the taxpayer for such consideration as will secure neither a gain nor a loss to SPI; that is, for £5,313,822. By s 274(1) of the same Act, if the taxpayer acquired the property as trading stock, the taxpayer is to be treated for the purposes of the Finance Act 1965, Sch 7, para 1, as having acquired it otherwise than as trading stock and immediately appropriated it as trading stock. Under the said para 1 a person making such an appropriation is generally treated, for the purpose of computing capital gains, as having thereby disposed of the appropriated asset by selling it for its market value, but he can elect instead that in computing his trading profit such market value shall be increased by the amount of the loss which would have accrued to him had he at the time of appropriation sold the asset for such market value. The taxpayer made such an election on 4 December 1975, and so claims to have made on the sale of APT a loss allowable in computing its profits of £2,213,822. Previously, on 12 March 1975, the taxpayer had executed a surrender of trading losses, pursuant to s 258 of the Income and Corporation Taxes Act 1970, with a view to group relief being obtained by other members of the Town & City Properties Group.

The Crown contends that the transaction does not produce its intended result for tax purposes because the taxpayer did not acquire the property from SPI as trading stock, and therefore the provisions of s 274(1) of the Act of 1970, never became applicable. Viewed in isolation from its motive and its consequences, the transaction was of a kind agreeable to the taxpayer's trade. The taxpayer was a property dealing company, it bought a landed property, and immediately sold it for a slightly higher price. There is nothing in the character or form of the transaction inconsistent with ordinary trade, and on that view, the taxpayer claims, the property must have been acquired as trading stock. However, the transaction would never have been undertaken for merely commercial purposes. But for the prospect of reducing the group's

A aggregate tax liabilities it must be inferred that SPI would have sold the property direct to APT. There is thus much force in the contention that it was not bought by the taxpayer as trading stock of a dealer in property, but as a piece of apparatus, a counter, with which a loss might be established within the group for tax purposes. The General Commissioners purported to find as a matter of fact that the transaction was a proper transaction in the course of the B taxpayer's trade, and accordingly discharged the assessment. The Crown now says that that determination was erroneous in point of law. It is not disputed that the transaction was genuine and not a sham, and there was evidence before the Commissioners that the taxpayer had previously acted as a property dealer within the group, buying or selling properties from or to other members for the purpose of its trade. Mr. Mummery, however, contends on behalf of C the Crown that they gave altogether too much weight to such evidence as justification for their view that in the present case the property was acquired as trading stock. He says that they erred also in saying that there was no evidence to indicate that the transaction was other than one in the normal course of business of the taxpayer since the tax motive of the transaction was obvious. He submits that the true and only reasonable conclusion from the agreed facts D is that, contrary to the Commissioners' view, the property was not acquired as trading stock.

In its broadest terms the question of law, I think, is this. If a property dealer carries out operations which in form and quality are within the ordinary scope of his trade, can they be held to be trading operations if they were carried out from an extraneous motive, such as reducing the liability to tax of E the trader or other persons, and but for that motive would not have been undertaken? For many general approach to a solution Mr. Mummery asks me to be guided by two very recent decisions of the House of Lords which were not available to the General Commissioners; namely, *W.T. Ramsay* v. *Commissioners of Inland Revenue*(1) [1981] 2 WLR 449; and *Commissioners of Inland Revenue* v. *Burmah Oil Co.*(2) [1982] STC 30. The facts of both cases F were much more complicated than those with which I have to deal, and I am content to guide myself, in the first instance, by Lord Wilberforce's observations in *Ramsay* at page 457 of the report. He said:

> "Given that a document or transaction is genuine, the Court cannot go behind it to some supposed underlying substance. This is the well known principle of Inland Revenue Commissioners v. *Duke of Westmin-* G *ster*(3) [1936] AC 1. This is a cardinal principle but it must not be overstated to overextended. While obliging the Court to accept documents or transactions, found to be genuine, as such, it does not compel the Court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or H series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded: to do so is not to prefer form to substance, or substance to form. It is the task of the Court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is I that series or combination which may be regarded. For this there is authority in the law relating to income tax and capital against tax: see *Chinn* v. *Hochstrasser*(4) [1981] 2 WLR 14 and *Inland Revenue*

(1) 54 TC 101. (2) 54 TC 200. (3) 19 TC 490. (4) 54 TC 311.

Commissioners v. *Plummer*(1) [1980] AC 896. For the Commissioners considering a particular case it is wrong, and an unnecessary self limitation, to regard themselves as precluded by their own finding that documents or transactions are not 'shams', from considering what, as evidenced by the documents themselves or by the manifested intentions of the parties, the relevant transaction is."

This citation is part of a passage in which Lord Wilberforce described himself as restating some familiar principles and some of the leading decisions.

It was followed, in the *Burmah Oil* case(2), by further observations on *Commissioners of Inland Revenue* v. *Westminster*(3), this time from Lord Diplock. I will read part of his speech from page 32 of the report:

"It would be disingenuous to suggest, and dangerous on the part of those who advise on elaborate tax-avoidance schemes to assume, that *Ramsay's* case(4) did not mark a significant change in the approach adopted by this House in its judicial role to a pre-ordained series of transactions (whether or not they include the achievement of a legitimate commercial end) into which there are inserted steps that have no commercial purpose apart from the avoidance of a liability to tax which in the absence of those particular steps would have been payable. The difference is in approach. It does not necessitate the over-ruling of any earlier decisions of this House; but it does involve recognising that Lord Tomlin's oft-quoted dictum in *Inland Revenue Commissioners* v. *Duke of Westminster*. . . : 'Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be', tells us little or nothing as to what methods of ordering one's affairs will be recognised by the courts as effective to lessen the tax that would attach to them if business transactions were conducted in a straight-forward way. The *Duke of Westminster's* case was about a simple transaction entered into between two real persons each with a mind of his own, the Duke and his gardener—even though in the nineteen-thirties and at a time a high unemployment there might be reason to expect that the mind of the gardener would manifest some degree of subservience to that of the Duke. The kinds of tax-avoidance schemes that have occupied the attention of the courts in the recent years, however, involve inter-connected transactions between artificial persons, limited companies, without minds of their own but directed by a single master-mind. In *Ramsay* the master-mind was the deviser and vendor of the tax-avoidance scheme; in the instant case it was Burmah, the parent company of the wholly owned subsidiary companies between which the pre-ordained series of transactions took place. Burmah was acting in accordance with advice obtained from advisers of the highest integrity who, in reliance on Lord Tomlin's dictum, did not foresee the difference in approach to tax avoidance schemes involving inter-company transactions that would have been adopted by this House by the time some nine years later when the particular scheme that they had devised in 1972 was eventually to come before it."

Both those passages encourage the view that the General Commissioners may have erred in the present case in considering the motive of the transaction not to have deprived it of a trading character. However, there are earlier decisions of the House of Lords, known as the dividend stripping cases, which

(1) 54 TC 1. (2) 54 TC 200; [1982] STC 30. (3) 19 TC 490. (4) 54 TC 101.

give more specific guidance in relation to the facts now in question, and to them I must next turn. In *J.P. Harrison (Watford)* v. *Griffiths*(1) 40 TC 281, a company, authorised by its memorandum of association to engage in share dealing, bought the share capital of another company with a view to obtaining payment of a large dividend and so establishing a trading loss by the consequent diminution in value of the shares. The Special Commissioners held that the transaction was not entered into as part of any trade of dealing in shares, but the House of Lords by a majority held them to have erred in law. Lord Simonds (at page 294) found it wholly immaterial, so long as the transaction was not a sham, what might be the fiscal results, or the ulterior fiscal object, of the transaction. Lord Morris (at page 302) thought that if, on any ordinary examination of them, certain transactions must be regarded as trading transactions, they did not cease to be such because those conducting them had embarked upon them with a view to obtaining some fiscal benefit. Lord Guest (at page 304) said the question to be asked was not, *quo animo* was the transaction entered into, but what in fact was done by the company. He answered it by saying: "The Company had power to deal in shares, it bought shares, it received a dividend on those shares, it sold the shares. This was just the ordinary commercial transaction of a dealer in shares". Such were the opinions of the majority in 1962. A case in the same field of debate, but of a far more complicated character, came before the House of Lords in 1966. It was *Finsbury Securitites Ltd.* v. *Bishop*(2) 43 TC 591. I will read a convenient summary of *Finsbury* from the judgment of Megarry J. in the later case of *Lupton* v. *F.A. & A.B. Ltd.*(3) 47 TC 580, at page 596. He said:

> "In the *Finsbury* case the headnote summaries 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' ". I interject the observation that that was s 341 in the Income Tax Act 1952. " '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, and found for the company on this point. Buckley J. upheld this decision, and 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 WLR, at page 1416, 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'."

(1) [1963] AC 1. (2) [1966] 1 WLR 1402. (3) [1972] AC 634.

Lupton(1) *itself—the case in which Megarry J. summarised Finsbury*(2) in the way I have just read—reached the House of Lords in 1971, and it required their Lordships to consider how a line could be drawn between cases of the *Harrison*(3) type and cases of the *Finsbury* type. Lord Dilhorne and Lord Donovan found it impossible to make a real distinction between the two; they thought that the *Finsbury* decision was clearly correct, and to be preferred to *Harrison*. Had that opinion been more widely shared, my task to-day would have been easy, for it would have become clear that a transaction which viewed as a whole, is entered into and carried out to secure a tax advantage is not a trading operation. The other speeches in *Lupton*, however, disclose a different view. Lord Morris distinguished *Harrison* and *Finsbury* in this way, at page 620 of the report:

> "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* [1966] 1 WLR 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."

Lord Guest (at page 623) found no inconsistency between *Harrison* and *Finsbury*; he agreed with the reasons given by Lord Morris. Lord Simon (at page 631) put the matter rather differently. He said(4):

(1) 47 TC 580. (2) 43 TC 591. (3) 40 TC 281. (4) 47 TC 580.

A "... 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 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 B 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 share (cf. also *Commissioners of Inland Revenue* v. *Dowdall O'Mahoney & Co. Ltd*(3) [1952] AC 401); (3) share-dealings and other business transactions vary almost infinitely; and to determine whether the C 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 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 D 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 transaction leaves the matter in doubt, an examination of its paramount object will always be relevant and will generally be E decisive."

Although opinions on the relevant principles of law were thus divided in *Lupton*(4), the House of Lords was unanimous in holding that the elaborate dividend-stripping operations there considered were not trading transactions. A similar result occurred in *Thomson* v. *Gurneville Securities Ltd.*(5) 47 TC 633, another example of complex dividend-stripping procedures, decided by F the same noble and learned Lords at the same time as *Lupton* and expressly on the same principles. Lord Morris (at page 673 of the report) abbreviated his previous exposition in the following words:

"So the question has to be considered whether there was here a trading activity of a dealer in shares. Whether a transaction is a usual or unusual one or whether it is a simple one or is complicated may be of no G account. The question is whether the transaction bears the stamp and mark of the trade of a dealer in shares or whether its very structure and content reveals it as something different in kind."

Lord Simon, too, supplied a short version of his proposition in *Lupton* when he said in *Thompson* (at page 679):

"My Lords, in *F.A. & A.B. Ltd.* v. *Lupton* I stated the question H which, on the view I formed of the authorities, fell for answer in this type of case—namely, whether, in the light of all the circumstances, the transaction is, on the one hand, a share-dealing which is part of the trade of dealing in shares (albeit intended to secure a fiscal advantage, or even conditioned in its form by such intention) or, on the other, a mere device

(1) 40 TC 281. (2) 43 TC 591. (3) 33 TC 259.
(4) 47 TC 580. (5) [1972] AC 661.

to secure a fiscal advantage (albeit given the trappings normally associated with a share-dealing within the trade of dealing in shares)." A

By those authorities I am, in my opinion, bound to hold that the principle of *Harrison*(1) still prevails within the limits indicated by the majority view in *Lupton*(2). I find nothing in the two recent cases, *Ramsay*(3) and *Burmah Oil*(4), that could justify me in disregarding the careful distinctions made by Lord Morris, Lord Guest and Lord Simon, or in giving way to a private B preference for the simpler and more readily applicable criterion of Lord Dilhorne and Lord Donovan. It will be remembered that Lord Diplock said, in the passage I have cited from *Burmah Oil*, that his new approach did not necessitate the overruling of any earlier decisions of the House of Lords. On that basis the present appeal must, in my opinion, fail. The transaction consisted of a straightforward purchase and a straightforward sale. It was not C so affected and inspired by fiscal considerations that its shape and character were no longer that of a trading transaction. Fiscal arrangements were not inherently or structurally part of what it is sought to describe as a trading transaction. Nor, in my understanding of Lord Morris's language, had the fiscal element so invaded the transaction itself that it was moulded and shaped by the fiscal elements. It bore the stamp and mark of the trade of a dealer in D landed property, rather than being revealed by its very structure and content as something different in kind. By the tests of Lord Simon (not quite identical, in my view, with those of Lord Morris and Lord Guest) I would describe the transaction (bearing in mind that Lord Simon thought *Harrison* authoritative within its narrow field) as dealings which were part of the trade of dealing in property, albeit intended to secure a fiscal advantage, rather than as a mere E device to secure a fiscal advantage albeit given the trappings normally associated with a dealing in property within the trade.

In his address in reply, Mr. Mummery was conscious that I found difficulty in distinguishing the present case from *Harrison*. He suggested that an important and perhaps the decisive element in *Finsbury*(5), as in *Lupton*, was the circumstance that the value of the consideration received by the F vendors of shares was made eventually to depend on the tax advantages obtained by the purchasers. So here, he said, SPI had the prospect of benefiting from group relief, and the case therefore lacks the purity of *Harrison*. I reject that submission for each of three reasons. First, because it comes too late. If it had been advanced before the General Commissioners, the taxpayer might have wished to present evidence showing whether in fact any G benefit to SPI resulted from the transaction or could have been in contemplation at the time it was carried out. Second, and most important, because in my view the submission misunderstands the distinction made by the majority opinions in *Lupton*. What prevented (or helped to prevent) some of the transactions in *Finsbury* and in *Lupton* from being share dealings in the course of trade was not the mere existence of vendors' benefits related to tax H recovery but their intrusive effect in determining the shape of the transactions, so that they no longer had the structure of the trading transactions. No such element is to be found in the present case. Thirdly, because of the practical inconvenience of Mr. Mummery's proposal. If it were necessary to investigate the indirect or consequential effects, actual or potential, of a transaction in order to determine whether it had a commercial quality, the difficult I distinction recognised in *Lupton*(6) would become still harder to apply in practice, a result to which I would not willingly contribute.

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(1) 40 TC 281. (2) 47 TC 580. (3) 54 TC 101. (4) 54 TC 200.
(5) 43 TC 591. (6) 47 TC 580.

A In the present case the transaction consisted of a purchase of leasehold property by a property dealer and its immediate sale. The purchase and the sale were made for the purpose of obtaining favourable tax consequences. The purchase was a real purchase. The leasehold was assigned to the taxpayer at law, and SPI was credited with an agreed sum of money. It was not something else disguised as a purchase. Similarly, the sale was a real sale, not something B else disguised as a sale. So far as I can see, to say that this real purchase and this real sale by a property dealer, taken (as they must be) to constitute a single transaction, were not trade dealings as alleged by such property dealer and as treated in its accounts, is only possible if one fastens on the motive of the transaction as necessarily decisive. But in my opinion to hold it so would be to disobey the remanent authority of *Harrison*(1).

C Accordingly, I cannot judge the General Commissioners to have erred in point of law when they found that the transaction was one in the course of the taxpayer's trade, and therefore discharged the assessment on the footing that the property was acquired by the taxpayer as trading stock. I dismiss the appeal.

Appeal dismissed, with costs.

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(2) REED v. NOVA SECURITIES LTD.

The case was heard in the Chancery Division before Walton J. on 29 July 1982 when judgment was given against the Crown, with costs.

C. N. Beattie Q.C. and *C. J. F. Sokol* for the Company.

J. Holroyd Pearce Q.C. and *P. H. Goldsmith* for the Crown.

E No cases were cited in argument.

REED v. *NOVA SECURITIES LTD.*

Walton J.—This appeal is concerned with transactions taking place within a group of companies, and the inter-relationship of capital gains or losses and trading profits or losses. Capital gains or losses made by companies F are dealt with on precisely the same principles as those of individuals, but any tax thereon is dealt with as part of its corporation tax: Income and Corporation Taxes Act 1970, s 265. Section 272 deals with a group of companies: the two companies with which this appeal is concerned were in a group. Section 273 provides that in that situation, when one member of the group disposes of an asset to another member of the group, then, save in G special circumstances not applicable here, the acquisition and disposal are at that notional figure which will produce neither gain nor loss for the company effecting the disposal. The effect of this is that the impact of any gain (or, equally, loss) is preserved until the asset is disposed of outside the group. Section 274(1) then deals with a special situation. It reads as follows:

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(1) 40 TC 281.

"Where a member of a group of companies acquires an asset as trading stock from another member of the group, and the asset did not form part of the trading stock of any trade carried on by the other member, the member acquiring it shall be treated for purposes of paragraph 1 of Schedule 7 to the Finance Act 1965 as having acquired the asset otherwise than as trading stock and immediately appropriated it for the purposes of the trade as trading stock."

If one then goes to para 1 of Sch 7 to the Finance Act 1965, the first sub-paragraph thereof is made subservient to the third, as amended by the Finance Act 1969, and they read:

"(1) Subject to sub-paragraph (3) below, where an asset acquired by a person otherwise than as trading stock of a trade carried on by him is appropriated by him for the purposes of the trade as trading stock (whether on the commencement of the trade or otherwise) and, if he had then sold the asset for its market value, a chargeable gain or allowable loss would have accrued to him, he shall be treated as having thereby disposed of the asset by selling it for its then market value". Sub-paragraph (3): "Sub-paragraph (1) above shall not apply in relation to a person's appropriation of an asset for the purposes of a trade if he is chargeable to income tax in respect of the profits of the trade under Case I of Schedule D, and elects that instead the market value of the asset at the time of the appropriation shall, in computing the profits of the trade for purposes of tax, be treated as reduced by the amount of the chargeable gain or increased by the amount of the allowable loss referred to in that sub-paragraph, and where that sub-paragraph does not apply by reason of such an election, the profits of the trade shall be computed accordingly."

Putting these provisions together, if one member of the group owns assets which do not form part of the trading stock of any trade carried on by it, in relation to which assets the position is that it acquired them for £X more than the current market value, if it disposes of those assets to another member of the group which acquires those assets as trading stock of a trade which is chargeable to income tax under Case I of Schedule D, and that other member of the group so elects, the profits of its trade are to be computed as if they were reduced by the sum of £X. I have put these provisions together in this way at the start of my judgment for the simple reason that a large part of the argument for the Crown in this appeal has apparently been based upon the proposition that, somehow, this case falls into the area of tax avoidance, thereby (it is said) attracting an entirely new approach to its subject-matter, as exemplified by the recent cases in the House of Lords of *W.T. Ramsay* v. *Commissioners of Inland Revenue*(1) [1981] 2 WLR 449 and *Commissioners of Inland Revenue* v. *Burmah Oil Co.*(2) [1982] STC 30. Such submissions are, in my judgment, entirely wide of the mark. The only questions in issue in the present case are: Has each step in the necessary chain of conditions been properly and correctly fulfilled? If it has, then the prospective capital gains loss will have been transmuted into a trade loss (with, of course, benefits to the group related to the difference in the rates of tax between capital gains and corporation taxes) by the very force of the provisions of the statutes. To equate this with tax avoidance is, once stated, seen to be wholly wide of the mark.

(1) 54 TC 101. (2) 54 TC 200.

Now what happened in the present case is that the Respondent company is a company whose trade is that of dealing in shares and securities. Its parent company, then known as Littlewoods Mail Order Stores Ltd. but now known as Littlewoods Organisation Ltd., had, as the result of an unsuccessful venture in Germany, certain assets of which it wished to dispose. So it offered them to the Respondent company by a letter dated 17 August 1973, which reads as follows:

> "Dear Sirs, Littlewoods Mail Order Stores Ltd. ('Littlewoods') is the beneficial owners of: 1. The whole of the registered share capital of Littlewoods Mail Order Stores GmbH (formerly called Medaillon Mode GmbH) of Offenbach/Main, West Germany (hereinafter referred to as 'Medaillon') amounting to DM 10,000,000. 2. Certain debts owing by Medaillon more particularly described in the Appendix hereto amounting in all to DM 18,576,032.50. 3. A debt originally owing by Medaillon Mode, Zurich, a wholly owned subsidiary of Medaillon, to Spiegel Inc. of Chicago U.S.A. and assigned to Littlewoods under Agreements of 24th October 1967 and 14th February 1969 amounting to DM 215,915.00. In addition, Littlewoods has made certain loans and advances to Medaillon amounting to DM 31,916,155.27. The only asset of Medaillon and its subsidiary is a building in Offenbach owned by Medaillon and which is being offered for sale. The only liabilities of Medaillon and its subsidiary, other than the above-mentioned debts, loans and advances, are mortgage loans from the Hessische Landesbank which are secured on the above-mentioned building. It is impossible to give any estimate or warranty as to the net amount that may be realised on the sale of the building after repayment of the secured loans to Hessische Landesbank, but after providing for disbursements and other expenses it is thought it may be of the order of £150,000 to £200,000. On the basis that the net proceeds amounted to £150,000 this would produce the sum of approximately £55,000 towards repayment of the debts referred to in 2 above and approximately £95,000 towards repayment of the loans and advances made by Littlewoods referred to above. We hereby offer to sell you the above-mentioned share capital of Medaillon, together with the debts referred to in 2 and 3 above for the sum of £30,000, payment to be made in cash against delivery of transfers of the shares and assignments of the debts duly executed by us. If you are prepared to accept this offer please let us have your formal acceptance when we will instruct our lawyers in Germany to prepare the necessary transfer and assignments accordingly. Yours faithfully, for and on behalf of Littlewoods Mail Order Stores Limited, C. D. Jackson, Finance Director."

By a letter of the same date the Respondent company accepted this offer. The formal agreement to give effect to this exchange of correspondence was dated 31 August 1973: nothing turns on its terms. It appears that, although not expressly so provided, when the matter came to be completed £10 of the total consideration of £30,000 was apportioned to the shares in the German company. On 15 August 1974, the Respondent company duly made the election provided for by para 1(3) of the Seventh Schedule to the Finance Act 1965. Later still, on 4 September 1975, the Respondent company surrendered some of the consequent losses to which (assuming that it was in fact so entitled to them) it had so become entitled in favour of other companies in the group, and those companies claimed loss relief accordingly.

On this brief recital of the history of the matter there is one and only one question which falls to be determined: Did the Respondent company acquire

the assets in question as trading stock? If it did, then it has brought itself within the precise provisions for the transmutation of a capital gains loss into a trading loss, and everything else is irrelevant. I have no doubt at all that, being properly advised, the group considered carefully what the consequences of the sale to the Respondent company would be, and calculated that they would be of benefit to the group as a whole. But that does not make the exercise in any way a tax avoidance scheme, any more than (for example) a covenant by a high taxpayer in favour of charity becomes a tax avoidance scheme merely because the taxpayer reckons correctly that it will bring him certain tax allowances. Indeed, this is all so obvious that I cannot help thinking that if it were not for the quite startling figures here involved—very nearly £4 million—nothing would ever have been heard of this case. The crucial point, then, is, of course, what is trading stock? This is defined for present purposes in s 45(1) of the Finance Act 1965, which is contained in Part III of that Act, which introduced the modern capital gains tax. That definition reads: "'trading stock' has the meaning given by" (as it now is, having been altered by the 1970 Act) "section 137(4) of the Income and Corporation Taxes Act 1970". Turning to that subsection, for present purposes the crucial part of the definition is: "'trading stock', in relation to any trade, means property of any description, whether real or personal, ... such as is sold in the ordinary course of the trade".

Mr. Holroyd Pearce, for the Crown, submitted that the assets sold to the Respondent company were not trading stock for a wide variety of reasons. First, he said that the effect of the sale was to transfer to the Respondent company for £30,000 worthless shares and speculative debts with a prospect of the recovery of a sum of £55,000 at an uncertain date. This was not a commercial transaction, as if the sale of the German company's property was long delayed the lost opportunity costs on the £30,000, together with the increase in the interest due to the German bank, would wipe out any prospect of a profit. In fact all we know about the return of the Respondent company is that a sum of £35,447.54*p* was received in part payment of the debts on 5 October 1979. Secondly, he says the transaction did not form part of the ordinary course of the trade of Nova because (a) worthless shares and commercial debts bore no resemblance to the shares in which Nova usually dealt; (b) there was no evidence as to the manner in which the £30,000 was to be financed. This was a large sum when compared with the total other holdings of the Respondent company of approximately £20,000. (c) The offer presented to the Respondent company did not indicate when the £55,000 would be received and this was a vital consideration in a trading context; (d) neither the shares nor the debts were ever resold.

The present appeal arises out of an assessment on the Respondent company to corporation tax for the accounting period 6 April 1973, to 31 December 1973, in the sum of £850. If it is correct in its contentions that it has fulfilled the necessary criteria to which I have referred above, it has, of course, a massive trading loss and not an insignificant profit. The Respondent company appealed against such assessment accordingly, and the matter came before the General Commissioners for the Division of Holborn, London, on 21 October 1980. Their decision was as follows: "We find as facts that the share capital and debts of Medaillon as set out in para 6 of the agreed statement of facts were acquired by Nova Securities Ltd. in the course of their trading in shares and securities and that they were acquired as trading stock. Accordingly we allow the appeal". The question for my decision, therefore, following the guidance given by Lord Radcliffe in *Edwards* v. *Bairstow*[1]

(1) 36 TC 207.

[1956] AC 14 at page 36, is whether the facts agreed by the parties and then found by the General Commissioners, as to which there is no dispute whatsoever, are such that no person acting judicially and properly instructed as to the law could have come to the determination under appeal. Indeed, Mr. Beattie for the Respondent company was prepared to go further, and would have argued, had it been necessary, that had the Commissioners reached a conclusion contrary to that which they did reach their decision could not have stood. I do not have to go as far as that, and do not propose so to do. It is sufficient for the determination of this appeal to say that the facts afford ample opportunity for reaching the conclusion which they did in fact reach.

As regards Mr. Pearce's first main point, it is not for the Inland Revenue to tell people how they shall conduct their business. Supposing that Nova had made a purchase in all respects similar to that which they had made, but from a third party outside the group, and by a lucky chance the transaction had turned out unexpectedly well, would the Revenue then have stood by and maintained that, whatever else it was, the transaction was not in the course of the Respondent company's trade? Of course not: they would have been only too glad to tax the profits. Of course, if a transaction were to be set up in such a manner that the Respondent company, come what may, could not possibly have made a profit, that would be an entirely different matter. But carrying on a trade is, to a large extent, about taking risks; and the Inland Revenue is not entitled to say that because it would not have taken such a risk (it never needs to take any) the trader may not do so as part of his trade. As regards Mr. Pearce's second main point, I suppose it is possible that different minds might conceivably take different views as to whether the transaction was or was not in the ordinary course of the Respondent company's business as it did in fact conduct it, given its previous portfolio. Certes it is that the Respondent company did, in fact, hold other unquoted shares besides those purchased from their parent company. I certainly cannot say that the General Commissioners erred if they took that view.

It would, however, in my view be erroneous in law if they did so, because the definition of "trading stock" in s 137(4) does not proceed upon what is the ordinary course of the taxpayer's business, but upon what is the ordinary course of the business carried on by the taxpayer. The crucial words are "'trading stock', in relation to any trade, means property . . . such as is sold in the ordinary course of the trade". You therefore have to determine what is "the trade" which is being carried on by the taxpayer. In the present case, the agreed statement of facts, at para 4, reads as follows: "The [Respondent company] commenced trading as a company dealing in shares and securities in 1955 and has continued that trade to the present day". The trade in question, therefore, is that of dealing in shares and securities, and it is not permissible to narrow that down any further. The only other point made by Mr. Holroyd Pearce which is worth specific comment is that calling attention to the fact that the shares were worthless, and the debts were retained and not sold on. So far as this latter point is concerned, a trader in shares and securities may make his profits in many ways. Resale is by no means essential; and if authority is required for so elementary a proposition it is to be found in the speech of Viscount Simonds in *J.P. Harrison (Watford), Ltd.* v. *Griffiths*(1) 40 TC 281 at pages 293 and 294.

(1) [1963] AC 1.

So far as the worthless shares are concerned, I could well understand (although I must not be taken as accepting) an argument that the purchase of shares by themselves which were worthless and unrealisable could not possibly be a purchase of trading stock. But, of course, in the present case they were acquired as part of a package, a minimal value being attributed thereto on completion. This, I think, produces an entirely different result anyway. The nature of the whole transaction cannot be influenced by the fact that, in order to acquire the assets you wish to acquire, you have to acquire also something of no real value which you might well be content never to have. I do not say that that was in fact the position here, because acquisition of the share capital might well have entitled the Respondent company to take steps to speed up the recovery of the debts. All I am saying is that, at its highest, the point is not, on the facts of the present case, a good one.

I trust I shall not be thought discourteous to Mr. Holroyd Pearce if, for the reasons I have endeavoured to set out, I consider that this case is basically an extremely simple one involving no consideration of tax avoidance. What I would point out is that in the series of tax avoidance cases proper (which include, in addition to those to which I have already referred, *Finsbury Securities Ltd.* v. *Bishop*(1) 43 TC 591; *Lupton* v. *F.A. & A.B. Ltd.*(2) 47 TC 580; *Thomson* v. *Gurneville Securities Ltd.*(3) 47 TC 633; *Commissioners of Inland Revenue* v. *Plummer*(4) [1980] AC 896; and *Coates* v. *Arndale Properties Ltd.*(5) (unreported), Goulding J., 24 March 1982) those cases in which the taxpayer has succeeded have all been cases where the form of the transaction has been precisely that which one would expect from a bare description of its nature, uncomplicated—undistorted, if you like—by any considerations based upon tax: whereas in those cases where the transaction has been so distorted—that is to say, where unusual features have been included in an otherwise simple transaction in order to produce a particular tax result—the taxpayer has uniformly lost. And this is, indeed, exactly as it should be. A genuine transaction is a genuine transaction, and should produce the taxation results which Parliament has enacted should follow, however distasteful those results are to the Inland Revenue. An artificial transaction should, at the very least, be closely scrutinised to see whether it is what it purports to be; and, as Lord Greene said many years ago, a taxpayer who plays with fire cannot complain if his fingers get burnt.

This appeal falls to be dismissed.

Appeal dismissed, with costs.

The Crown's appeals were heard in the Court of Appeal (Lawton, Fox and Kerr L.JJ.) on 24, 25, 26, 27, 28 and 31 October 1983 when judgment was reserved. On 6 December 1983 judgment was given unanimously in favour of the Crown, with costs and in the second case by a majority in favour of the company, with costs.

(1) [1966] 1 WLR 1402. (2) [1972] AC 634. (3) [1972] AC 661.
(4) 54 TC 1. (5) [1982] STC.

A *J. F. Parker Q.C.* and *J. Mummery* for the Crown in *Coates* v. *Arndale Properties Ltd.*

A. Park Q.C. and *M. Flesch Q.C.* for Arndale Properties Ltd.

J. Holroyd Pearce Q.C. and *P. H. Goldsmith* for the Crown in *Reed* v. *Nova Securities Ltd.*

C. N. Beattie Q.C. and *C. J. F. Sokal* for Nova Securities Ltd.

B The following cases were cited in argument in addition to those referred to in the judgments:—**Arndale Properties Ltd.:** *The Incorporated Council of law Reporting* v. *Commissioners of Inland Revenue* 3 TC 105; *The Religious Tract and Book Society of Scotland* v. *Forbes* 3 TC 415; *Iswera* v. *Ceylon Court of Taxation* [1965] 1 WLR 663; *Dowdall, O'Mahoney & Co. Ltd.* v. *Commissioners of Inland Revenue* 33 TC 259; [1952] AC 401. **Nova Securities**
C **Ltd.:** *Skinner* v. *Berry Head Lands Ltd.* 46 TC 377; [1970] 1 WLR 1441; *Furniss* v. *Dawson* 55 TC 324; [1984] 2 WLR 226.

COATES v. *ARNDALE PROPERTIES LTD.*
REED v. *NOVA SECURITIES LTD.*

Lawton L.J.—These two appeals, which we heard one after the other,
D raise the same issues and are concerned with the application of the same statutory provisions and the same principles of law to those issues. In each case the principal issue was whether the company taxpayer, being a member of a group of companies, had acquired "an asset as trading stock" so as to bring into operation ss 265(1) and 274(1) of the Income and Corporation Taxes Act 1970, and para 1(3) of Sch 7 to the Finance Act 1965. If they had, they could
E bring into account as trading losses capital losses which had been sustained by the members of the group from whom they had acquired the assets. In both cases this would have meant that for the year of assessment the company would have had no liability for corporation tax and other members of the group would have obtained substantial fiscal advantages because in each case the company, pursuant to s 258, had surrendered part of its right to relief for
F trading losses to other members of its group. In both cases the Commissioners for the General Purposes of the Income Tax decided that the tax-paying companies had acquired the assets as trading stock. The Inland Revenue, as Appellants, have submitted that these findings were such that no Commissioners, acting judicially and properly instructed as to the relevant law, could have made them, so that they were erroneous in point of law: see s 56 of
G the Taxes and Management Act 1970, and *Edwards* v. *Bairstow*[1] [1956] AC 14. The reason for this submission was that in both cases on the admitted facts the sole, or alternatively the paramount, reason for acquiring the assets was to get fiscal advantages. In neither case did the tax-paying company call evidence. The facts which the parties thought relevant were agreed at the hearings before the Commissioners. Convenient though this practice may be in many cases, in
H my opinion it is unsatisfactory when the amounts in issue are large and the Inland Revenue are alleging that the transactions being examined were nothing more than machinery to obtain fiscal advantages. Because of what was agreed, in this Court we have been unable to look beyond the facts found in the cases and in the documents exhibited to them. In the *Arndale Properties Ltd.* case, however, it was admitted in this Court that before the Commissioners the

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[1] 36 TC 207.

company's case had been conducted on the basis that the relevant asset had been acquired solely in order that the group to which it belonged should obtain a fiscal advantage in the form of tax relief. A

The Law—by Part 3 of the Finance Act 1965, persons become chargeable to capital gains tax in respect of chargeable gains accruing to them in a year of assessment: see s 20. Chargeable gains were defined by s 22. They were to arise from the disposal of assets, which were deemed to be all forms of property, including debts. Profits made in the course of trade were not chargeable gains. Provision, however, had to be made for the case where a trader acquired an asset otherwise than as trading stock and later appropriated it for the purposes of his trade as trading stock. A chargeable gain could accrue (see para 1(3) of Sch 7); but that sub-paragraph was not to apply B

> "in relation to a person's appropriation of an asset for the purposes of a trade if he is chargeable to income tax in respect of the profits of the trade ... and elects that instead the market value of the asset at the time of the appropriation shall, in computing profits of the trade for the purposes of tax, be treated as reduced by the amount of the gain or increased by the amount of the loss referred to in that sub-paragraph, and where that sub-paragraph does not apply by reason of such an election, the profits of the trade shall be computed accordingly." C D

The effect of this provision was that a trader who had made a capital loss on the acquisition of an asset could turn it into a trading loss by bringing it into his trading stock and then making the election provided for by para 1(3).

Capital gains tax was not payable by companies; but they could make gains and losses on the disposal of capital assets. By s 49(1) of the Finance Act 1965, companies became chargeable to corporation tax on all their profits wherever arising; but by s 55 (now s 265 of the 1970 Act) the computation of chargeable gains was to take into account any allowable losses. We were told by Mr. Beattie, for Nova Securities Ltd., that a loss on the disposal of a capital asset may be an allowable loss but when computed it may not have the same fiscal advantage as if it were treated as a trading loss. I accept that this is so. E F

Special provisions had to be made for the disposal of assets within a group of companies. This was done in Sch 13, para 3(1), which provides as follows:

> "Where a member of a group of companies acquires an asset as trading stock from another member of the group, and the asset did not form part of the trading stock of any trade carried on by the other member, the member acquiring it shall be treated for purposes of paragraph 1 of Schedule 7 to this Act as having acquired the asset otherwise than as trading stock and immediately appropriated it for the purposes of the trade as trading stock." G

This sub-paragraph is now s 274(1) of the 1970 Act. When read with s 273(1) this provision produces this result, as the Crown in this Court accepted, viz., that if one member of a group of companies, not being a dealing company, sustains a capital loss on an asset and sells that asset at its market value to a dealing member which acquires it "as trading stock", the dealing company is deemed to have acquired it for a consideration which gives the disposing company neither a gain nor a loss. From this it follows that if the dealing company sells it to another company at its market value and that value is less than the cost to the original disposing member, the dealing company is deemed to have made a trading loss. Trading losses can be used to give tax relief from corporation tax. When there are a number of companies in a group this relief H I

A can be surrendered to one or more members of the same group. The fiscal advantages which can flow from all this are illustrated by the facts of the Nova Securities Ltd. case. If that company did acquire the assets which it did "as trading stock" it made a deemed trading loss for the year of assessment of £3.9 million which it could properly set off against the admitted chargeable gains of £850; but if it surrendered that relief to other members who had made large
B chargeable gains those members could get substantial fiscal advantages by way of tax relief.

The managers and advisers of a group of companies, one of whose members has sustained a capital loss, are entitled to keep in mind the statutory provisions to which I have referred and to arrange the affairs of the group to get the best fiscal advantages they can. This is trite law but in order to get the
C maximum fiscal advantages the transactions which are intended to produce those advantages must be such as to come within the statutory provisions which give it. In both these appeals the fiscal advantages could not be obtained unless the two companies had acquired the relevant assets "as trading stock". What do these words mean?

The Definition of Trading Stock—the word "as" coming after
D "acquires" connotes the purpose for which the acquisition was made. Trading stock is defined in s 137(4) of the 1970 Act as follows:

> "For the purposes of this section, 'trading stock', in relation to any trade, means property of any description whether real or personal, being either—
>
> (a) the property such as is sold in the ordinary course of the trade,
E or would be so sold if it were mature or if its manufacture, preparation or construction were complete or
>
> (b) ..."

Mr. Park, for Arndale Properties Ltd., accepted that this definition, although prefaced with the words "for the purposes of this section", applied whenever the words "trading stock" were used in the 1970 Act. Mr. Beattie, for Nova
F Securities Ltd., submitted that these prefacing words limited the application of the definition to the subject matter of s 137, namely the valuation of trading stock on discontinuance of trade. When the words "trading stock" were used in other sections they should be construed as words of ordinary English usage which could give a meaning different from the statutory definition. This would be a strange consequence of Parliamentary drafting if the submission were
G well-founded, which it is not. Section 137(4) in the 1970 Act reproduced s 143(4) of the Income Tax Act 1952. Section 45(1) of the 1965 Act, gave statutory definitions of a number of words and phrases for the purposes of the provisions of that Act relating to capital gains and referred back to s 143(4) of the 1952 Act (now s 265 of the 1970 Act). Section 55 of the same Act applied the principles for computing capital gains to the computation of chargeable
H gains for corporation tax purposes. Paragraph 1 of Sch 7 to the 1965 Act, sets out rules for computing capital gains in relation to trading stock and para 3 of Sch 13 applied the capital gains rules relating to trading stock to group companies. This meant that the definition of trading stock in s 45(1) applied for the purposes of computing chargeable gains relating to the trading stock of group companies. Paragraph 3 of Sch 13 is now s 274 of the 1970 Act. It
I follows, so it seems to me, that the words "trading stock" should have the same meaning whether it is applied to capital gains or chargeable gains and that meaning is the statutory one as set out in the 1952, 1965 and 1970 Acts.

This definition, when referring to "the trade" means the taxpayer's trade. It follows that Commissioners, when considering the application of s 274(1) of the 1970 Act, have to decide whether the property acquired was of the kind in which the taxpaying company traded. In both these cases it was. But the fact that it was of the same kind does not mean that it was acquired "as trading stock". It must have been acquired for the purpose of being used in the course of trade.

What is Trade?—None of the tax statutes defines "trade" and "trading" further than to provide that trade includes any trade, manufacture, adventure or concern in the nature of trade. In *Ransom* v. *Higgs*(1) [1974] 1 WLR 1594, Lord Reid said at page 1600 H:

> "As an ordinary word in the English language 'trade' has or has had a variety of meanings or shades of meaning. Leaving aside obsolete or rare usage it is sometimes used to denote any mercantile operation but it is commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services. The context in which the word 'trade' has been used in the Income Tax Acts appear to me to indicate that operations of that kind are what the legislature had primarily in mind."

In my judgment if the acquisition of an asset lacks a commercial character it cannot be said to have been acquired as trading stock: but if it has this character the reason why the acquisition was made, in the absence of other factors, ought not to deprive it of that character. Whether a transaction has a commercial character is a question of mixed fact and law. It is a question of law what the words "acquires an asset as trading stock" in s 274(1) of the 1970 Act mean and a question of fact whether the transaction in question comes within that meaning. If, as I think, the words connote a transaction having a commercial character and on the facts found the Commissioners could reasonably have adjudged that it had such a commercial character, they cannot be said to have made a determination which was erroneous in point of law within the meaning of s 56(1) of the Taxes Management Act 1970. It follows that their determination cannot be set aside by this Court: see *Edwards* v. *Bairstow*(2) [1956] AC 14.

The dividend stripping cases—In construing the relevant words in s 274(1) in this way I have kept in mind the series of cases in the House of Lords which were concerned with dividend stripping. They are as follows: *J. P. Harrison (Watford), Ltd.* v. *Griffiths* 40 TC 281; *Finsbury Securities Ltd.* v. *Bishop*(3) 43 TC 591; *Lupton* v. *F.A. & A.B. Ltd.*(4) 47 TC 580 and *Thomson* v. *Gurneville Securities Ltd.*(5) 47 TC 633. Each of these cases was concerned with the construction and application of the following words in s 341 of the Income Tax Act 1952 (now s 168(1) of the 1970 Act): "Where any person sustains a loss in any trade, profession, employment or vocation carried on by him ...". Although the concept of trade has to be considered in construing both s 341(1) of the 1952 Act and s 274(1) of the 1970 Act, the word "as" in s 274(1) invited the Commissioners in each of these cases to determine why the asset had been acquired. In the *Harrison* case the House of Lords (Lords Reid and Denning dissenting) adjudged that it was irrelevant to enquire why the

(1) 50 TC 1. (2) 36 TC 207. (3) [1966] 1 WLR 1402.
(4) [1972] AC 634. (5) [1972] AC 661.

A losses had been sustained. In the later cases their Lordships' House adjudged that the claimed losses had not been sustained in any trade since the relevant transactions had not been trade at all but tax avoidance schemes. In the *Lupton*(1) case, Lord Donovan at page 629 described the transaction there in issue as follows:

> "My Lords, the ordinary trader in stocks and shares normally makes
> B 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 bought pursuant to a plan having as its objects (*a*) to provide
> C 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 dispersed in tax, and which on recovery they would share with the vendors of the shares. I say that this is not trading in stocks and
> D 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."

In the same case Viscount Dilhorne said at page 628:

> "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
> E 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 initially, but also to the manner of its implementation."

I have found difficulty in reconciling the decision in *Harrison's*(2) case with
F those in the later case. We were invited by the Inland Revenue to adjudge that the later cases had impliedly over-ruled *Harrison*. I cannot do so for three reasons: first, it is for their Lordships' House to adjudge which of its decisions are still authoritative; secondly, in the *Lupton* case their Lordships were invited to depart from the decision in *Harrison* to the extent of holding that a transaction whose sole or main purpose was to secure a repayment of income
G tax was not within the ambit of the word "trade" (see page 616) but they did not do so, perhaps because the facts of *Lupton's* case bore more than the badges of tax avoidance—they were the very garb of that activity; and thirdly, the words of s 274(1) on their proper construction required the Commissioners to enquire in each of these cases why the assets were acquired. If on the facts of these cases the acquisitions could reasonably be adjudged to have had a
H commercial character, when viewed as a whole, so as to make them acquisitions as trading stock, the determinations must stand. But this Court can set them aside if on the facts no person acting judicially and properly instructed as to the relevant law could have come to the same determination as the Commissioners did.

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(1) 47 TC 580. (2) 40 TC 281.

THE ARNDALE CASE

APL is one of a number of wholly-owned subsidiaries of Town and City Properties Ltd. These companies are known as the Town and City Group. APL deals in land. Another similar subsidiary is Sovereign Property Investments (Newport) Ltd. ("SPI") which is a property development company. A third subsidiary is Arndale Property Trust Ltd. (APTL) which is an investment company. On two occasions before 30 March 1973, APL had bought properties from APTL. The Commissioners found that APTL had acted as a property dealing firm within the group, buying and selling properties from and to associated or subsidiary companies for the purpose of its business.

For some time before 30 March 1973 SPI had been concerned with a property development scheme at Newport, Gwent, pursuant to a lease for 125 years granted to it by the Corporation of Newport. By 30 March 1973, it had spent £5,313,822 on this development but its market value was only £3,100,000. By an assignment made on 30 March 1973, (which was the day before the end of APL's financial year) SPI transferred the land held under the lease and the buildings upon it to APL for what was stated to be a consideration of £3,100,000. No cash passed. One of the companies within the Town and City Group acted as banker to the other members. The payment was effected by book entries made by this banking company. The book entries which were made showed a consideration of £3,090,000. By another assignment made on the same day APL transferred the land and buildings to APTL for the same consideration as was mentioned in the other assignment. A banking book entry was made for this amount with the result that the book entries showed that APL had made a profit of £10,000.

As these two assignments had been made between members of a group of companies, s 273(1) of the Income and Corporation Taxes Act 1970, applied to the transaction between SPI and APL so that the transfer was deemed to have produced neither a gain nor a loss to SPI and APL were deemed to have acquired the property at a price of £5,313,822. The property was not part of SPI's trading stock. It was one of its capital assets. Land and buildings, however, were assets with which APL traded and could be trading stock as defined in s 137(4), in property such as was sold in the ordinary course of APL's trade. If APL did acquire the property "as trading stock" s 274(1) of the 1970 Act applied. APL were to be treated for revenue purposes as having acquired the asset otherwise than as trading stock and having immediately appropriated it for the purposes of its trade as trading stock. If s 274(1) did apply, under para 1 of Sch 7 to the Finance Act 1965, APL's appropriation to its trading stock was made at the property's market value, which was £3,100,000, and the difference between the market value and the deemed consideration under s 273(1), that is £2,213,822, could be treated as a trading loss if an election was made under para 1(3). On 12 March 1975, under the group relief provisions of the 1970 Act (ss 258–264) APL consented to the surrender of its trading losses to the other members of the Town and City Property Group; and on 4 December 1975, it made an election under para 1(3).

All this can be stated shortly. If APL did acquire the property from SPI "as trading stock" it could bring its notional trading loss into account for the purpose of assessment of corporation tax for the year ended 31 March 1973; and if it could, no tax would be payable for that year. But if it could not, it would have to pay corporation tax on chargeable gains of £28,072 and the other members of the group would not get benefit by way of tax relief from the trading losses surrendered to them.

The Commissioners decided that APL had acquired the property "as trading stock" even though, as was admitted, the officers of Town and City Properties Ltd. responsible for overall group policy, no doubt on the advice of the group's advisers, had decided that the property should be sold to APL and immediately resold to APTL solely in order that that Group should obtain a fiscal advantage in the form of tax relief for the large and genuine loss which SPI had suffered. Had SPI assigned the property directly to APTL the fiscal benefits which are said to have accrued to APL and other members of the group would not have been available. There is no mention of this admission in the Case Stated, but in this Court it was agreed by Mr. Park on behalf of APL that it had been made. Further, the Commissioners did not state in terms that they had considered the relevance of this admission. Mr. Park submitted that we should infer that they did because of their references to artificial transactions. I am willing to draw this inference. Their approach was that APL dealt in real property. The assignments effected in a straightforward manner what they purported to effect, namely the purchase and sale of property. They were not shams but genuine transactions. The assignments did transfer the rights and obligations which they purported to transfer and the transactions related to assets of a kind in which APL dealt.

In my judgment the Commissioners cannot have directed themselves properly as to the relevant law. They should have looked at the transactions as a whole and should not have confined themselves to the legal effect of the two assignments. The transactions do not bear the badges of trade. Within the group there was no commercial reason why SPI should not have assigned the lease directly to APTL. No cash passed. The profit to APL of £10,000 could not have been much of an incentive for the assignment to APTL because on its face no provision was made for profit. The assignment through APL could only have been made for the purpose of getting a fiscal benefit. It follows that the assignment by SPI to APL must have been for the same purpose. It could not have been "as trading stock". When deciding otherwise the Commissioners made a determination which was erroneous in point of law. Goulding J. considered himself bound to uphold the determination because of the decision in *Harrison's*[1] case. Assuming, as I must, that the judgment in that case as to the construction of s 341(1) of the 1952 Act, is binding upon this Court, I distinguish this case from that on the ground that it is concerned with the construction and application of s 274(1) of the 1970 Act.

THE NOVA SECURITIES CASE

The Commissioners had to determine whether Nova Securities Ltd. ("Nova") had been lawfully assessed for corporation tax on profits of £850 in respect of their accounting period which ended on 31 December 1973. The Commissioners set the assessment aside having adjudged that Nova's trading losses, which exceeded £850, could be set off against the profits. This seemingly small case is the tip, so submit the Inland Revenue, of a gigantic tax avoidance iceberg because, if this determination is correct, other companies in the group to which Nova belong (the Littlewoods Group) will be able to obtain substantial tax relief on large profits. The legal issues are the same as in the *Arndale* case but there are differences when the facts are compared.

Nova was incorporated on 25 February 1955. Its primary object was "to invest and raise and borrow money for investment in the purchase or acquisition or upon the security of any stocks, bonds, debentures, scrip or

(1) 40 TC 281.

securities of any kind". This it did over a number of years in a small way. Before April 1973 it seems to have bought and sold quoted securities. On 15 March 1973 the whole of the issue share capital of Nova was acquired by the Littlewoods Organisation Ltd. ("Littlewoods") who formed part of a group of companies ("the Littlewoods Group"). Before 15 March 1973, Littlewoods had undertaken a commercial venture in Western Germany through a West German subsidiary, Medaillon Mode GmbH ("Medaillon") which had been financially disastrous. Medaillon owed DM 31,916,155 to Littlewoods. This had arisen because Littlewoods had guaranteed Medaillon's bank borrowings. Medaillon's only asset was some premises in Offenbach which had been mortgaged to a West German bank. Littlewoods' losses arising from this West German venture were not chargeable losses for the purposes of computing corporation tax. Its only chance of recouping any of these losses lay in the value of the Offenbach premises when the mortgage had been paid off. Upon sale of these premises and the repayment of the mortgage Medaillon could have paid off a small part of its debt to Littlewoods. After Nova became a member of the Littlewoods Group some of Littlewoods' directors were appointed to its board.

By letter dated 17 August 1973, Littlewoods offered to sell to Nova for the sum of £30,000, the whole of the registered share capital of Medaillon, debts owing by Medaillon to them amounting to DM 18,576,032 and debts owing by a Swiss subsidiary to Littlewoods amounting to DM 215,915. The letter referred to the premises in Offenbach and went on as follows:

> "It is impossible to give any estimate or warranty as to the net amount that may be realised on the sale of the building after repayment of the secured loans to Hessiche Landesbank, but after providing for disbursements and other expenses it is thought it may be of the order of £150,000/ £200,000. On the basis that the net proceeds amounted to £150,000 this would produce the sum of approximately £55,000 towards repayment of the debts referred to above and approximately £95,000 towards repayment of the loans and advances made by Littlewoods referred to above."

Nova accepted the offer by a letter of the same date. This was possible because Littlewoods and Nova were occupying the same premises in Liverpool. There is nothing in the case to show how or when the consideration of £30,000 was paid, if it ever was, or what led Nova to decide that this was a worthwhile deal. On 31 August 1973, an agreement was entered into between Littlewoods and Nova recording that the debts had been sold to Nova for £29,990 and that Nova had paid £10 for the shares.

For the purposes of corporation tax the debts and shares sold by Littlewoods to Nova had been acquired by Littlewoods at a cost of £3,936,765. As a consequence of the application to the transaction of s 273 of the 1970 Act, Nova were deemed to have acquired them for this sum. Nova's accounts were made up from 6 April 1973 to 31 December 1973. On submitting these accounts to the Inspector of Taxes Nova claimed to have incurred a trading loss for tax purposes of £3,905,950. The Inspector refused the claim and issued an assessment of tax on profits of £850, which profits were admittedly made from other transactions. On 4 September 1975, agreements were entered into between Nova and three other members of the Littlewoods Group (being Littlewoods, Littlewoods Warehouses Ltd. and John Moores Home Shopping Services Ltd.) on terms that Nova would receive a sum equal to 50 per cent. of any tax saved as a result of the surrender of the Nova losses. Subsequently

each of the three other members of the Littlewoods Group claimed group relief of £1,301,971 under s 258 of the 1970 Act, in respect of losses surrendered to them by Nova. The claims were refused by the Inland Revenue and appeals against these refusals are outstanding. The registered share capital of Medaillon bought by Nova from Littlewoods on 17 August 1973, has not been sold but a sum of £35,447.54 was received by Nova from Medaillon on 5 October 1979, in part payment of the debts upon the sale of Medaillon's premises in Offenbach.

On these facts the issue is this: did Nova acquire the debts and shares as trading stock? In my judgment the only reasonable inference to be drawn from the facts is that the sale of the debts and shares would never have come about if those who planned it had not seen fiscal advantages in what was going to be done. A desire, however, on the part of the Littlewoods Group to obtain a fiscal advantage is irrelevant if the transaction which was undertaken to give effect to the desire can reasonably be said to be an acquisition by Nova of an asset as trading stock. What Nova acquired was a kind of asset which it could sell in the ordinary course of its trade; but it was an abnormal transaction of a size and kind which, as far as can be inferred from the schedules of dealings, it had not undertaken before August 1973 and never did again. The circumstances in which the agreement was made are not those of normal trading in securities as described by Lord Donovan in *Lupton*(1). There is, however, this important fact. Nova had the prospect of acquiring for £30,000 assets of a kind in which it dealt and a chance of making a profit of £25,000 on the deal. There is nothing in this case going to show that the chance was fanciful. The outcome was delayed and the profits were smaller than hoped for, but profit there was. A deal of this kind does have a commercial character and was consistent with the acquisition of assets as trading stock. The transaction, however, must not be looked at in isolation. The Commissioners had to have regard to its inception, to the arrangements made initially and to the manner of implementation: see Viscount Dilhorne in *Lupton* as above. In my judgment had the Commissioners viewed the transaction as a whole they could not reasonably have come to the conclusion, as they did, that Nova had acquired the debts and shares as trading stock. Their error, as was that of Walton J., from whose judgment there has been an appeal to this Court, was not to view the transaction as a whole. Since the decisions in *Lupton* and *W. T. Ramsay Limited* v. *Inland Revenue Commissioners*(2) [1982] AC 300, it is now clear that the Commissioners and the courts should always do so.

I would set aside the Commissioners' determinations in both these cases.

Fox L.J.—SPI Ltd., Arndale (the taxpayer company) and APT Ltd. were members of a group of companies wholly controlled by Town and City Properties Ltd. SPI was a developer, Arndale a dealing company assessable under Case I and APT was an investment company.

SPI purchased the Newport property and developed it. By 30 March 1973, SPI's total outlay on the acquisition and development was £5,313,822. On that date the property was sold by SPI to Arndale for £3,090,000. On the same day Arndale re-sold the property to APT for £3,100,000. The latter figure was the open market value of the property on 30 March 1973. The purchase considerations were dealt with by book entries within the group.

(1) 47 TC 580. (2) 54 TC 101.

The reason for the transactions on 30 March 1973, is not in doubt. It was accepted before us by Counsel for Arndale that

> "The officers responsible for overall group policy, no doubt acting on the advice of the group's advisers decided that the property should be sold to Arndale and immediately re-sold solely in order that the group should obtain a fiscal advantage in the form of tax relief for the large and genuine loss which SPI had suffered."

That has been accepted at all stages of the case.

The issue on these facts (and in consequence of the elections made on 4 December 1975) is whether Arndale acquired the property on 30 March 1973 "as trading stock" within the meaning of s 274(1) of the Income and Corporation Taxes Act 1970. I agree with Lawton L.J. that the definition of "trading stock" in s 137(4) of the Act of 1970, is applicable to this case (and to the *Nova Securities Case*.) Applying it accordingly I think the property was of the kind in which Arndale traded. The Commissioners found that Arndale was an established trading company and that it had in the past purchased properties for its trading stock. That however is only part of the problem. The crucial matter is the purpose for which the acquisition was made. That is the consequence of the word "as". The stock must be acquired for use in the course of the company's trade.

Against that background, the first question is the effect of the decision of the House of Lords in *Griffiths* v. *J. P. Harrison (Watford) Ltd.*[1] [1963] AC 1 ("*Harrison*").

In *Harrison* a company called Claiborne had ceased to trade and had accumulated profits of £15,900; those profits had borne tax. The Respondents bought the issued shares in Claiborne for £16,900, with a view (it was found) to obtaining a dividend against which they would set off losses. Claiborne proceeded to declare a dividend of some £15,901.19s.3d. The Respondents then sold the shares for £1,000. The Respondents claimed that, in consequence of these matters, it made a loss on trading in shares of £15,900.

The House of Lords, by a majority (Viscount Simonds, Lord Morris and Lord Guest) held that the transaction was a trading transaction. Viscount Simonds, at page 12, said that it was wholly immaterial, so long as the transaction was not a sham, what might be the fiscal result or ulterior motive of the transaction and since that, in his view, would be the only ground upon which the Commissioners could have concluded that the transaction was not trading, the taxpayer must succeed. Lord Morris, at page 23, said that the transaction 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 some tax recovery might be claimed. Lord Guest, at page 27, said that one has to look at the transaction by itself irrespective of the fiscal consequences and ask 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.

In the present case the view of the Judge was this. There was a genuine purchase of property by a property dealing company which immediately sold it at a profit. The transaction was not a sham. Accordingly, the only ground for

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[1] 40 TC 281.

A asserting that the dealings were not trade dealings was because the motive was fiscal. But to do so would be to disobey *Harrison*(1). Accordingly, he could not regard the Commissioners as having erred.

Whatever *Harrison* must now be taken as deciding is binding on this Court. But the ambit of the decision can no longer be found within its own pages. It must be read with *Finsbury Securities Ltd.* v. *Inland Revenue*
B *Commissioners*(2) [1966] 1 WLR 402 ("Finsbury"), *Lupton* v. *F.A. & A.B. Ltd.*(3) [1972] AC 634 ("Lupton") and *Thomson* v. *Gurneville Ltd.*(4) [1972]AC 661. The last three cases were dividend stripping operations of considerable complexity in which there had been a purchase of shares by a trading company followed by a declaration of dividend which gave rise to the alleged trading loss. The issue in each case was whether the dealing in the
C shares could be regarded as a trading transaction. The House of Lords held in each case that it could not.

In *Lupton* at page 646, Lord Morris said that the transactions in *Harrison* "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
D introduced any fiscal element". He contrasted that with *Finsbury*, where the transaction included provisions relating to the fiscal object of the transaction, namely the recovery of the tax and its division between the parties. He regarded *Finsbury* as distinguishable from *Harrison*. So did Lord Guest (at page 650). Viscount Dilhorne, however (at page 656) thought the cases were indistinguishable and that *Finsbury* was rightly decided. So did Lord Donovan
E (at page 658) in *Lupton* and in *Thomson* v. *Gurneville*, [1972] AC 661 at page 676). Lord Simon in *Lupton* (at page 659) was of opinion that *Harrison* was a "very narrow decision indeed".

There were, therefore, some differences of opinion in *Lupton*. But what does emerge clearly from *Lupton* (and is, I think, inherent in *Finsbury* is that the transaction must be looked at as a whole (see Viscount Dilhorne in *Lupton*
F at page 657, Lord Donovan at page 658 and Lord Simon at page 658 (proposition (3)). *Thomson* v. *Gurneville*, which was heard immediately after *Lupton* and by the same members of the House, does not depart from that. The approach is reinforced by *W. T. Ramsay Ltd.* v. *Commissioners of Inland Revenue*(5) [1982] AC 300.

The proposition that the matter must be considered as a whole differs
G substantially, I think, from the approach of the majority in *Harrison* who, as pointed out by Lord Donovan in *Lupton*, reached their conclusion "by examining the component parts of the transaction i.e. the purchase of the shares, the receipt of the 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 a dealing in shares". He went on to observe that, in *Finsbury*, the
H component parts of the transaction if considered alone would logically have produced the same result as in *Harrison*, but the House in *Finsbury* looked at the transaction as a whole and so reached the opposite conclusion.

It is apparent from *Lupton* that the purpose of the transaction, looked at as a whole, may be crucial. Thus, Viscount Dilhorne at page 657 said

(1) 40 TC 281. (2) 43 TC 591. (3) 47 TC 580.
(4) 47 TC 633. (5) 54 TC 101.

"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 section 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 . . .".

I refer also to Lord Donovan at page 657 and Lord Simon at page 659. It seems to me therefore that, in the light of the cases after *Harrison*[1], Viscount Simonds' statement in *Harrison* that it was wholly immaterial, so long as the transaction was not a sham, what might be the ulterior fiscal motive of the transaction is not now an accurate statement of the law in relation to such a problem as arises in the present case. Lord Guest in *Harrison* said that one has to look at the transaction by itself irrespective of fiscal consequences. That remains correct. But the same does not apply to fiscal purposes. The result in my view, is that *Harrison,* read in the light of the later cases, does not compel one to any conclusion in the present case. All the circumstances of the individual case must be considered in order to determine the true nature of the relevant transaction.

I come then to the facts of the present case. It seems to me that, on the admitted facts, the sole purpose of the transactions between SPI, Arndale, and APT was to obtain a fiscal advantage in the form of tax relief in respect of SPI's large loss on the Newport property. I do not doubt that trading transactions can take place between members of the same group of companies (and in fact the statute assumes that they can). But there can have been no genuine trading purpose in the acquisition of the property by Arndale. The acquisition was not a sham but it was merely a formal step in the scheme to obtain the tax benefit. The property was only in Arndale's hands for a short period. It was at once (certainly on the same day) sold and transferred to APT. It thus remained in the group. There is nothing to suggest that the Board of Arndale ever considered the matter at all. But even if they did, it is evident that what was done was in pursuance of decisions of officers responsible for overall group policy and as part of the implementation of a fiscal scheme. I accept that there was a profit made by Arndale on the assignment to APT (though the draftsman of the assignment to Arndale got the figures wrong). But that does not tell one much, since the profit, as I understand it, made no difference to the group's finances.

We are, it seems to me, left with a transaction the sole purpose of which was to obtain a fiscal benefit. Can one then say that the property was acquired by Arndale "as trading stock"? It seems to me that the words "trading stock" must imply an acquisition for a trading purpose; and I think that to constitute a trading purpose the purpose must be commercial in character. In the present case there was only a trading purpose in the sense that the object was to bring the case within the statute and the statute requires a trading purpose if the tax benefit is to be obtained. Consequently, Arndale acquired the property intending to re-sell it.

But the reality is that Arndale did not acquire the property to trade with. Arndale's purpose was not commercial. Arndale acquired the property to obtain a tax benefit. Lord Simon in *Lupton*[2] at page 660 said

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(1) 40 TC 281. (2) [1972] AC 634.

A "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".

That, I think, states the essence of the decisions in *Finsbury*(1), *Lupton*(2), and *Thomson v. Gurneville*(3). The acquisition by Arndale is, in my opinion, B properly described "as a device to secure a fiscal advantage". If that is right then I think that the true and only reasonable conclusion in the present case (see *Edwards v. Bairstow*(4) [1956] AC 14 at page 36) is that the property was not acquired by Arndale "as trading stock". Accordingly, in my view, the determination of the Commissioners was erroneous in law and should be set aside and this appeal allowed.

C *REED* v. *NOVA SECURITIES LTD.*

There was no oral evidence in this case. An agreed Statement of Facts was put before the Commissioners by the parties. The material facts as they appear from that Statement are as follows:-

(i) Nova was incorporated in 1955 and, in that year, commenced trading as a dealer in shares and securities. It continued that trade thereafter and was D still trading down to the hearing before the Commissioners.

(ii) Turnover increased in the years from 5 April 1972 to 31 December 1978, from about £20,000 in the first of those years to about £106,000 in the last.

(iii) In March 1973 the whole of the issued share capital of Nova was acquired by Littlewoods Organisation Ltd. ("Littlewoods"). At the same time E three new directors, two of whom were directors of Littlewoods and one of them being the Finance Director of Littlewoods Group, were appointed.

(iv) On 17 August 1973, Littlewoods offered in writing to sell to Nova for £30,000 (a) the whole of the share capital (of DM 10,000,000) of a German company called Littlewoods Mail Order Stores GmbH (which was then called Medaillon Mode GmbH and which I will call "Medaillon"); (b) Debts owed F by Medaillon to Littlewoods, amounting to some DM 18,000,000; and (c) a debt owing by Medaillon to Littlewoods, amounting to about DM 215,000. All the debts referred to in (b) except for about DM 547,000 were in respect of bank loans, repayment of which had been guaranteed by Littlewoods.

(v) On receipt of the offer a board meeting of Nova was held at which the terms of the offer were considered and (I quote from the agreed Statement) "it G was noted that on the basis of the information contained in the letter the sum of approximately £55,000 would be received towards repayment of the debts which would be acquired if the offer was accepted". It was resolved that the offer be accepted and on 17 August 1973, Nova accepted the offer. A formal agreement was entered into on 31 August.

(vi) For the purposes of corporation tax on capital gains the shares and H debts sold to Nova were acquired by Littlewoods for £3,936,765. By virtue of s 273 of the Income Tax Act 1970, the shares and debts were acquired by Nova for purposes of corporation tax on capital gains for the same amount.

(vii) In August 1974 Nova made an election under Sch 7 of the Finance Act 1965, that in computing its profits for corporation tax the market value of

(1) 43 TC 591. (2) 47 TC 580. (3) 47 TC 633. (4) 36 TC 207.

the shares and debts acquired from Littlewoods should be treated as increased by £3,906,765, being the amount which would have been the allowable loss accruing to Nova under para 1(1) of Sch 7 had no such election been made.

(viii) In September 1975, agreements were entered into between Nova and three other members of Littlewoods Group that Nova should receive a sum equal to 50 per cent. of any tax saved as a result of surrender by Nova of its losses.

(ix) Nova has not sold the Medaillon share capital but a sum of £35,447 has been received by Nova from Medaillon in part payment of the debts on sale of Medaillon's premises at Offenbach (referred to in Littlewoods' letter of offer on 17 August 1973).

(x) The acquisition from Littlewoods was substantially larger in amount than any single transaction previously entered into by Nova. That appears from the Schedules of investments.

On these facts, the Commissioners, without specifying their reasons, found that Nova acquired the shares and debts of Medaillon as trading stock.

The present appeal is by way of Case Stated under s 56 of the Taxes Management Act 1970. A party who is dissatisfied with the determination of the Commissioners is only entitled to require a Case to be stated on the basis that he is "dissatisfied with the determination as being erroneous in point of law" (s 56(1)). Section 56(3) requires the High Court "to hear and determine any question of law arising on the Case". If the present appeal is to succeed, therefore, it must be shown that the Commissioners erred in law. There is nothing in the Case Stated which, ex facie, is bad law. The question, therefore, is whether it can be said that the true and only reasonable conclusion contradicts the determination. That can be put, in different language, as whether it can be said that no tribunal, acting judically and properly instructed on the law, could reasonably have reached the conclusion which was in fact reached by the Commissioners.

I suspect that, as in the *Arndale Case,* the sole purpose of the acquisition by the trading company (Nova in this case) was to obtain a fiscal benefit for the Group. But there is no finding to that effect by the Commissioners. There is no statement to that effect in the agreed Statement of Facts. And there has been no other agreement or concession to that effect; the *Arndale Case* is quite different in that respect.

The Court is, however, entitled to draw proper inferences from the admitted facts. Can it be inferred from the admitted facts that the sole, or indeed the principal, purpose of the acquisition by Nova was fiscal? I do not think so. It is quite true that the transaction was larger in amount and, so far as the property acquired was concerned, somewhat different in character from those which Nova had previously entered into. But the transaction was not ultra vires and the fact that a trading company chooses to trade in larger amounts than previously does not seem to me to be any clear indication that it was doing anything but trading. It is true that Nova made an election under Sch 7 but if the property was indeed acquired as trading stock it would have done the same thing if it wished to take lawful advantage of the provisions of the statute. One must, of course, look at the transaction as a whole and in the light of the circumstances surrounding it. But doing so does not lead me on the evidence available to the conclusion on a balance of probabilities that the sole or paramount object of the transaction was fiscal benefit. Parliament cannot

have contemplated that a trading company claiming the benefit of the statutory provisions should have been ignorant of, or indifferent to, the tax advantages when the property was purchased. It must, therefore, be legitimate for a company when deciding to acquire property "as trading stock" to take into account tax benefits which may follow, though the acquisition itself must be for trading purposes and not merely for fiscal purposes. In the present case we know that the Board of Nova met to consider Littlewoods' offer and took note of the fact that £55,000 would, on the information available, be recovered on the debts. That would produce a profit of £25,000. There is no evidence to what extent the Board were influenced by fiscal considerations. I think that if the Revenue wanted so fundamental a finding as that the sole or paramount purpose of the acquisition was fiscal, they should have insisted on oral evidence before the Commissioners and sought a finding of fact to that effect. I do not think we can infer it.

The question then is whether, in these circumstances, the Court can conclude that no reasonable tribunal, properly instructed, could have decided, on the evidence, that the property was acquired by Nova "as trading stock". I do not think that the Court would be justified in doing that. Nova was a trading company. It bought property of a kind in which it was authorised to deal (namely shares) and securities and in which it had traded down to the time of the hearing (see para 4 of the Agreed Statement of Facts). The property acquired can therefore properly be described as "trading stock" within s 137(4) of the Act of 1970. Before deciding to buy the property the Board of Nova considered what, in ordinary commercial terms, was the profit which Nova was likely to make on the transaction. There is no evidence as to the extent to which the Board was influenced by fiscal considerations, though the fiscal benefit was ultimately claimed. Nova, in the event, did make a commercial profit, though on the available figures it was smaller than anticipated.

In my opinion it is a perfectly possible view of those facts (and taking into account the considerations I have already mentioned when considering the question of fiscal objects) that the property was acquired by Nova as trading stock. Looking at the whole matter, I find it impossible to say that no tribunal properly instructed could reasonably have concluded as did these Commissioners.

I would dismiss the appeal.

COATES v. *ARNDALE PROPERTIES LTD.*

Kerr L.J.—I agree with both the judgments which have been delivered. Applying *Edwards* v. *Bairstow*[1] the only reasonable inference is that the sole purpose of those in control of the group, as well as those in control of Arndale, if the latter were ever consulted in a separate capacity, was to obtain a fiscal advantage for the group by routeing the transfer of the property from SPI to APT via Arndale. There can have been no other reason for interposing Arndale as a conduit pipe in a transfer carried out in two steps when its sole commercial purpose required no more than a single and direct transfer from SPI to APT. The immediately following transfer by Arndale to APT was predestined before Arndale became owner of the property, perhaps only for a

(1) 36 TC 207.

matter of minutes or even seconds. In these circumstances, for the reasons which have been stated, I think that it is impossible to conclude that Arndale acquired this property "as trading stock", and I agree that this appeal should be allowed.

REED v. *NOVA SECURITIES LTD.*

This is a much more difficult case, on which my mind has wavered. I should certainly prefer to reach the same conclusion as Lawton L.J., because there is an inevitable suspicion that the sole purpose of Nova's acquisition of the shares and debts owed by Medaillon was to obtain a fiscal advantage for the group. Indeed, this may already have been the planned purpose when Littlewoods bought Nova only about five months earlier. But ultimately my clear conclusion is that on the basis of *Edwards* v. *Bairstow*[1] there is insufficient material to entitle the Court to overturn the Commissioners' finding that Nova acquired the shares and debts of Medaillon as trading stock. Mr. Holroyd Pearce Q.C. rightly reminded us that the burden rests on the taxpayer to displace the assessment upon him and that the Court can take this into account on an appeal from the Commissioners: see *Shadforth* v. *Fairweather & Co. Ltd.* 43 TC 291. But on the agreed facts I think that Nova have done so in this case or—more accurately—that the Court is not entitled to say that the Commissioners could not reasonably have so concluded. Moreover, I was impressed by Mr. Beattie Q.C.'s reminder to us that under the legislative provisions which are applicable in these group trading stock cases, Parliament has expressly permitted a group of companies to convert a capital loss into a revenue loss if the group contains a trading company dealing in assets of the kind in question which acquires the asset as part of its trading stock. It therefore seems to me that in transactions of this nature there may well be a greater legitimate fiscal element—as a partial purpose underlying the transaction—than in the dividend stripping cases, in which less specific legislative provisions fall to be considered. Throughout the hearing of both of these cases I therefore doubted whether *Harrison* v. *Griffiths*[2] and the decisions which followed and distinguished it, are really in pari materia and deserve the prominence which they assumed during the argument.

I agree with the reasons stated by Fox L.J. for dismissing this appeal. There is also another aspect of the facts to which some weight should in my view be given. Once Nova had become part of this group, it seems to me that it may have been the commercially sensible course for Nova to acquire the shares and debts of Medaillon from Littlewoods in order to deal with these assets—such as they were—on a commercial basis. They were assets whose acquisition, realisation and disposal were within Nova's business as a dealer in shares. It may well have been a commercially sensible decision for Nova to take over Medaillon from Littlewoods, as part of Nova's stock in trade, rather than to leave it to Littlewoods to carry out this salvage operation. The attendant fiscal advantage would of course not have been overlooked, and may well have been a paramount consideration. Nevertheless, the transfer of the shares and debts to Nova, as a dealer in assets of this nature, could well have had a real commercial purpose from the point of view of the policy of the group as a whole. I therefore do not agree that the only reasonable conclusion open to the Commissioners was that the sole purpose of the acquisition of the Medaillon shares and debts by Nova was the attainment of a fiscal advantage for the group. I think that it was open to the Commissioners to conclude that Nova acquired the shares and debts as part of its trading stock in order to deal

(1) 36 TC 207. (2) 40 TC 281.

A with the Medaillon fiasco in the interests of the group as a whole, and I would accordingly dismiss this appeal.

Appeal allowed, with costs in the first case.

Appeal dismissed, with costs in the second case.

Leave granted to appeal to the House of Lords in both cases.

B (1) COATES v. ARNDALE PROPERTIES LTD.

The Company's appeal came before the House of Lords (Lords Keith of Kinkel, Edmund-Davies, Bridge of Harwich, Brandon of Oakbrook and Templeman) on 2 and 3 October 1984 when judgment was reserved. On 22 November 1984 judgment was given in favour of the Crown, with costs.

J. Parker Q.C. and *P. Goldsmith* for the Crown.

C *A. Park Q.C.* and *M. Flesch* for the Company.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Floor* v. *Davies* 52 TC 609; [1979] 2 WLR 830; *Edwards* v. *Bairstow* 36 TC 207; [1956] AC 14; *The Commissioners of Inland Revenue* v. *Incorporated Council of Law Reporting* 3TC 105; *Iswera* v. *Ceylon Commissioners of Inland Revenue* [1965] 1 WLR 663; *Bishop* v. D *Finsbury Securities Ltd.* 43 TC 591; [1966] 1 WLR 1402; *Reed* v. *Nova Securities Ltd.* TC Leaflet 3016 [1984] STC 124; *Lupton* v. *F.A. & A.B. Ltd.* 47 TC 580; [1972] AC 634; *W.T. Ramsay Ltd.* v. *Commissioners of Inland Revenue* 54 TC 101; [1982] AC 300.

COATES v. *ARNDALE PROPERTIES LTD.*

E **Lord Keith of Kinkel**—My Lords, I have had the opportunity of reading in advance the speech to be delivered by my noble and learned friend, Lord Templeman. I agree with it, and for the reasons he gives would dismiss the appeal.

Lord Edmund-Davies—My Lords, I am in respectful and complete agreement with the views expressed in the speech prepared by the noble and F learned Lord, Lord Templeman. I accordingly concur in holding that this appeal should be dismissed.

Lord Bridge of Harwich—My Lords, for the reasons given in the speech of my noble and learned friend, Lord Templeman, with which I agree, I would dismiss this appeal.

Lord Brandon of Oakbrook—My Lords, I have had the advantage of G reading in draft the speech prepared by my noble and learned friend, Lord Templeman. I agree with it, and for the reasons which he gives I would dismiss the appeal.

Lord Templeman—My Lords, Town and City Properties Ltd. is the parent of a group of companies which includes the three wholly-owned subsidiary companies featured in this appeal. The first subsidiary, Sovereign Property Investments (Newport) Ltd. ("SPI"), carries on business as a property developer. SPI acquired a lease for 125 years of land at Newport in Gwent and developed the site at a total cost of £5.3 million. The market value of the lease on 30 March 1973, according to the group, was £3.1 million. SPI thus faced a potential capital loss of £2.2 million which might be reduced or eliminated by an increase in the value of the land prior to its eventual disposal. Any loss in fact suffered on disposal would then rank as an allowable loss which could only be set off for corporation tax purposes against chargeable gains (if any) made by SPI. The second subsidiary, the Appellant Arndale Properties Ltd. ("Arndale"), carries on business as a property dealer; any losses incurred by Arndale in carrying on that business are trading losses which can be set off in any year against trading profits made by Arndale or by any other member of the group. There were therefore sound commercial reasons for converting the potential capital loss of SPI into a trading loss suffered by Arndale and there is express statutory provision which enables this to be done for corporation tax purposes. By assignment dated 30 March 1973 SPI assigned the lease to Arndale for £3.1 million. According to the accounts of SPI and Arndale the price in fact paid was £3,090,000 and in these proceedings it has been assumed that the accounts, supported as they were by the auditors, are more accurate than the assignment. The object of the assignment was to enable Arndale to convert the potential capital loss of £2.2 million which threatened SPI into a trading loss for corporation tax purposes of £2.2 million to be suffered by Arndale and then to be available for distribution between all members of the group to set against trading profits. This conversion is made possible by the legislation but only if Arndale acquired the lease "as trading stock" for the purposes of its property-dealing business.

The third subsidiary of the group, Arndale Property Trust Ltd. ("APTL"), carries on business as an investment company. By assignment also dated 30 March 1973 Arndale assigned the lease to APTL for £3.1 million. Arndale could then proceed to complete the conversion of the potential capital loss of £2.2 million into an actual trading loss for corporation tax purposes and to distribute that trading loss between the companies of the group, provided that Arndale had acquired the lease "as trading stock". The effect of the assignment to APTL was to ensure that the lease became a capital asset of APTL and thus remained a capital asset of the group.

The legislation which confers power on a group of companies to procure the conversion of a potential capital loss into a trading loss provided certain conditions are fulfilled must now be considered.

By s 238 of the Income and Corporation Taxes Act 1970 a company is chargeable to corporation tax in respect of income and in respect of chargeable gains. By s 265 chargeable gains are to be included in the total profits of a company assessable to corporation tax after deducting any allowable losses accruing to that company. Chargeable gains to be included for corporation tax purposes are computed in accordance with the principles applying to capital gains tax subject to any express provisions enacted with regard to companies. Thus, as I have already indicated, if SPI having acquired and developed land at a cost of £5.3 million had sold it on the open market for £3.1 million, the sale would have produced an allowable loss of £2.2 million deductible in computing the chargeable gains (if any) liable to corporation tax of SPI.

Sections 272 to 281 make express provisions for corporation tax in connection with a group of companies and each member of that group. In particular, s 273(1) provides:

> "where a member of a group of companies disposes of an asset to another member of the group, both members shall... be treated, so far as relates to corporation tax on chargeable gains, as if the asset... were acquired for a consideration of such amount as would secure that... neither a gain nor a loss would accrue..."

Thus although the lease was in fact assigned by SPI to Arndale for £3,090,000, the lease is deemed for corporation tax purposes to have been assigned for £5.3 million. If that provision had stood alone, then the assignment by one member of the group, SPI, to another member of the group, Arndale, would have had no effect on the corporation tax liability of either company save that when Arndale eventually sold the lease a chargeable gain or allowable loss would result to Arndale depending on the difference between the price obtained by Arndale and the original cost to SPI, namely £5.3 million.

Where, however, a member of a group transfers an asset to a trading member, difficulties arise. These difficulties are similar to those which arise when an individual who carries on a trading business appropriates property to or from his business activities as trading stock. In *Sharkey* v. *Wernher*[1] [1956] AC 58, for example, a transfer of a horse from a stud farm carried on as a business to a racing stable carried on as a recreation produced tax consequences for the business similar to those which would have been produced by a sale of the horse at market value.

By s 274(1) of the Income and Corporation Taxes Act 1970:

> "Where a member of a group of companies acquires an asset as trading stock from another member of the group, and the asset did not form part of the trading stock of any trade carried on by the other member, the member acquiring it shall be treated for purposes of paragraph 1 of Schedule 7 to the Finance Act 1965 as having acquired the asset otherwise than as trading stock and immediately appropriated it for the purposes of the trade as trading stock."

The lease did not form part of the trading stock of SPI. Provided that Arndale acquired the lease "as trading stock" of the property dealing business carried on by Arndale, then Arndale is deemed to have acquired the lease otherwise than as trading stock and immediately appropriated it for the purposes of the trade as trading stock. Paragraph 1 of Sch 7 to the Finance Act 1965, makes provisions, similar in some respects to the results achieved in the case of individuals by the decision in *Sharkey* v. *Wernher* in the event of the appropriation of an asset as trading stock.

Paragraph 1(1) of Sch 7 to the Act of 1965, as amended provides:

> "Subject to sub-paragraph (3) below, where an asset acquired by a person otherwise than as trading stock of a trade carried on by him is

(1) 36 TC 275.

appropriated by him for the purposes of the trade as trading stock... and, if he had then sold the asset for its market value, a chargeable gain or allowable loss would have accrued to him, he shall be treated as having thereby disposed of the asset by selling it for its then market value."

The confusing result is that if Arndale acquired the lease as trading stock it is treated as having first acquired the lease for £5.3 million otherwise than as trading stock, then as having appropriated the lease as trading stock, then as having sold the lease for its market value, namely £3.1 million, thus as having made an allowable loss of £2.2 million. Paragraph 1(3) of Sch 7 however confers an option on the trading company to convert the allowable loss of £2.2 million into a trading loss of £2.2 million. By para 1(3):

"Sub-paragraph (1) above shall not apply in relation to a persons appropriation of an asset for the purposes of a trade if he is chargeable to income tax in respect of the profits of the trade... and elects that instead the market value of the asset at the time of the appropriation shall, in computing the profits of the trade for purposes of tax, be treated as reduced by the amount of the chargeable gain or increased by the amount of the allowable loss referred to in that sub-paragraph, and where that sub-paragraph does not apply by reason of such an election, the profits of the trade shall be computed accordingly:..."

Thus if Arndale purchased the lease from SPI "as trading stock" for the purposes of the property-dealing trade of Arndale then Arndale may elect that the acquisition cost of the lease shall be entered in its trading accounts as £5.3 million and not £3.1 million and thus when Arndale sold the lease to APTL for £3.1 million Arndale for corporation tax purposes would suffer a trading loss of £2.2 million.

Provision is made for such a trading loss to be applied for the benefit of the group. By s 258 of the Income and Corporation Taxes Act 1970, headed "Group Relief":

"(1) Relief for trading losses... may... be surrendered by a company... which is a member of a group of companies and, on the making of a claim by another company ... which is a member of the same group, may be allowed to the claimant company by way of a relief from corporation tax called 'group relief'."

Arndale claimed that it acquired the lease "as trading stock" and pursuant to that claim elected that para 1(3) of Sch 7 to the Act of 1965, as amended should apply, and surrendered to other members of the group relief from the alleged trading loss of £2.2 million.

The conversion of a potential capital loss into a trading loss for corporation tax purposes and the distribution of the benefit of that trading loss by way of group relief cannot however be achieved unless an asset is transferred from a non-trading member of the group to a trading member and is acquired by the trading member as "trading stock" of the business carried on by the trading member. If this were not the case the practical distinction between chargeable gains and profits for the purposes of calculation of corporation tax could be largely eliminated by including at least one trading company in a group. The extent to which such distinction is desirable is not a matter for present discussion. For the conversion of a capital loss into a trading loss it must be shown that a capital asset has been appropriated as trading stock.

A On behalf of Arndale it was submitted that Arndale was carrying on its trade as a property dealer when it bought and sold the lease. A trader may buy and sell simultaneously; a trader may even sell in anticipation of buying. One subsidiary company may trade with another subsidiary company in the same group. Arndale traded and made a profit of £10,000. If, in addition, Arndale was able to make available group relief amounting to £2.2 million so much the B better. The purchase from SPI and the sale to APTL were no different in substance from a purchase from or sale to a third party having no connection with the group. Arndale bought the lease as trading stock and traded with it.

In my opinion Arndale never decided to acquire and never did acquire, the lease as trading stock. The group's advisers procured the transfer of the lease from SPI to Arndale and from Arndale to APTL with the object of C obtaining group relief of £2.2 million trading loss without in fact changing the lease from a capital asset to a trading asset. The group seeks the advantage of treating the lease as trading stock while ensuring that the group retains the lease as a capital asset at all times. Arndale followed instructions and lent to the transaction its name and its description as a property-dealing company. Arndale did not trade and never had any intention of trading with the lease. In D order to give the whole transaction a faint air of commercial verisimilitude, the trading company Arndale was awarded the modest sum of £10,000 for entering into two assignments of property worth over £3 million. The award of £10,000 was ostensibly made at the expense of APTL which paid Arndale for the lease £10,000 more than the price paid by Arndale to SPI. In reality the award of £10,000 was made at the expense of SPI which sold for £10,000 less E than the market value assessed by the group. The profit of £10,000 did not represent the difference between the price at which Arndale negotiated the purchase and the price at which Arndale negotiated the sale. The profit of £10,000 did not represent the difference between the value of the lease to SPI and the value of the lease to APTL. The profit of £10,000 was a timid veil designed to conceal the fact that the lease was not being traded. Moreover, all F three companies being wholly owned subsidiaries of the same parent, the £10,000 was a book entry which had no material effect on the overall financial position of the group.

I conclude therefore that, while Arndale acquired the lease, it did not acquire the lease as "trading stock" within s 274(1) of the Act of 1970 and therefore never was in a position to exercise the election provided by para 1(3) G of Sch 7 to the Act of 1965. In these circumstances it is unnecessary to consider the application of the principles enunciated by your Lordships' House in *Commissioners of Inland Revenue* v. *Burmah Oil Co. Ltd.*(1) [1982] STC 30 and *Furniss* v. *Dawson*(2) [1984] AC 474 to a case where the legislature has made express provision for the mitigation of tax by the conversion of a capital loss into a trading loss provided certain conditions are fulfilled. It is also H unnecessary to consider whether the dividend-stripping cases since 1963 have finally stripped the decision in *Griffiths* v. *J.P. Harrison (Watford), Ltd.*(3) [1963] AC 1 of its value to the tax-avoider. In the present case the legislature has expressly provided a method of tax mitigation designed no doubt to ensure that a group of companies is in no worse position than an individual whose activities embrace all the activities of a group of companies. The taxing I statutes allow a potential capital loss to be converted into a trading loss in respect of an asset which becomes part of the stock-in-trade of the trading activities of the group. The lease never became part of the trading assets of any

(1) 54 TC 200. (2) 55 TC 324. (3) 40 TC 281.

company in the group. The Court of Appeal reached the same conclusion and the appeal must be dismissed. A

Appeal dismissed, with costs.

[Solicitors:—Speechly Bircham & Co.; Solicitor of Inland Revenue]

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(2) REED *v.* NOVA SECURITIES LTD.

The Crown's appeal came before the House of Lords (Lords Keith of Kinkel, Edmund-Davies, Bridge of Harwich, Brandon of Oakbrook and Templeman) on 3 and 4 October and 29 November 1984 when judgment was reserved. On 31 January 1985 judgment was given allowing the Crown's appeal in part with no order for costs. B

J. Parker Q.C. and *P. Goldsmith* for the Crown.

C. Beattie Q.C. and *C. Sokol* for the Company. C

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Snell* v. *Rosser, Thomas & Co. Ltd.* 44 TC 343; [1968] 1 WLR 295; *Imperial Tobacco Co. Ltd.* v. *Kelly* 25 TC 292;

REED v. *NOVA SECURITIES LTD.*

Lord Keith of Kinkel—My Lords, I have had the benefit of reading in advance the speech to be delivered by my noble and learned friend, Lord Templeman. I agree that, for the reasons which he states, the appeal should be allowed in part and an order made in the terms which he proposes. D

Lord Edmund-Davies—My Lords, I am in agreement with the speech prepared by my noble and learned friend, Lord Templeman. I would accordingly allow the appeal in part and make the order proposed by him. E

Lord Bridge of Harwich—My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Templeman. I fully agree with it and with the order he proposes allowing the appeal in part.

I add a word only to express my own emphatic opinion, in concurrence with that of my noble and learned friend, that this was a case where the Crown owed it to the general body of taxpayers to ensure that their case was competently conducted before the General Commissioners. A claim to tax relief on nearly £4,000,000 turned on the result. The facts were, to say the least, unusual and a difficult issue of fact arose for decision. In these circumstances any competent advocate experienced in tax matters would have realised that, if the Crown were to succeed on the grounds unsuccessfully argued before Walton J. and the Court of Appeal, it was essential to leave the taxpayers to prove their case before the Commissioners by oral evidence. The background to the transactions in question could then have been thoroughly explored in cross-examination. This might very well have elicited material to support the conclusion of fact reached in the dissenting judgment of Lawton L.J. F G

Instead the Crown allowed the case to proceed before the Commissioners on an exiguous agreed statement of facts. In the result the Crown have only themselves to blame that, so far as the debts are concerned, neither Walton J., nor the majority of the Court of Appeal, nor any of your Lordships feel able to interfere with the inference which the Commissioners drew from the facts so agreed.

Lord Brandon of Oakbrook—My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Templeman. I agree with it, and for the reasons which he gives I would allow the appeal in part only as proposed by him.

Lord Templeman—My Lords, the Respondent taxpayer company Nova Securities Ltd. ("Nova") claims to have sustained a trading loss for corporation tax purposes amounting to £3,905,915 for the accounting period 6 April 1973 to 31 December 1973. The Appellant, the Inland Revenue, denied that Nova had sustained a trading loss and raised an assessment on an admitted trading profit of £850.

By s 238 of the Income and Corporation Taxes Act 1970, corporation tax is charged on the profits of a company and profits means income and chargeable gains. By s 265(2) the total amount of chargeable gains to be included in the profits of a company for the purposes of corporation tax shall, save as otherwise provided, be computed in accordance with the principles applying for capital gains tax. By s 265(1) the amount to be included in respect of chargeable gains in a company's total profits for any accounting period shall be the total amount of chargeable gains accruing to the company in that period after deducting any allowable losses accruing to the company in that period and any remaining allowable losses previously accruing to the company while it has been within the charge to corporation tax. Thus an allowable capital loss sustained by a company may only be set off in the computation of the corporation tax payable by that company and in respect of capital gains, if any, made by that company. On the other hand by s 258, for the purposes of corporation tax, relief from a trading loss may be surrendered by a company which is a member of a group of companies in favour of other companies included in that group. By s 274 of the Act of 1970 and para 1 of Sch 7 to the Finance Act 1965, group relief may be made available by converting a capital loss sustained by one company in the group into a trading loss sustained by another member of that group provided certain conditions are fulfilled, in particular provided that an asset pregnant with loss is transferred within the group to a trading company which acquires the "asset as trading stock". In *Coates* v. *Arndale Properties Ltd.*(1)[1984] 1 WLR 1328 your Lordships decided that a group of companies failed to obtain group relief because the asset responsible for the loss was not acquired by a trading company pursuant to s 274(1) "as trading stock". In the present case Nova assert and the Inland Revenue deny that Nova acquired certain debts and shares as trading stock.

The Littlewoods Organisation Ltd. ("Littlewoods") acquired the whole of the issued share capital of a West German company, Medaillon Mode G.m.b.H. ("Medaillon"). The acquisition cost to Littlewoods of the Medaillon shares amounted to £1,512,599. Littlewoods also guaranteed

(1) TC Leaflet 3015.

payment of certain of Medaillon's bank overdrafts. This venture by Littlewoods into the Federal Republic appears to have been a disaster. Littlewoods were called upon to pay under their guarantees and took assignments of the debts owed by Medaillon to the banks. The acquisition cost to Littlewoods of the bank debts amounted to £2,424,166. In addition Littlewoods advanced to Medaillon sums amounting in the aggregate to a further £4.8m. Thus Littlewoods were faced, subject to any possibility of recovery from Medaillon, with the prospect of a capital allowable loss of £1.5m in respect of Medaillon shares and a capital allowable loss of £2.4m in respect of Medaillon's bank debts. Littlewoods could not claim an allowable loss in respect of the advances of £4.8m which Littlewoods had made directly to Medaillon because by para 11 of Sch 7 to the Act of 1965 and s 23(2) of that Act the loss suffered by an original creditor is not an allowable loss for capital gains purposes. The prospective allowable loss of £1.5m attributable to the shares of Medaillon and £2.4m attributable to the Medaillon bank debts could only be set off against capital gains (if any) made by Littlewoods and could not be transferred to the group of companies of which Littlewoods was the parent.

With the object, no doubt, of converting their allowable losses into trading losses available for group relief, Littlewoods on 15 March 1973 acquired the whole of the issued share capital of Nova which thus became a member of the group of companies headed by Littlewoods. Nova had been in existence since 1955 as a company dealing in shares and securities, capable therefore of sustaining trading losses in respect of shares and debts. In the year ended 5 April 1973 Nova traded in shares and securities to the extent of £20,615 and made a trading profit of £1,048.

By a letter dated 17 August 1973 Littlewoods, whose board of directors included two out of the three directors of Nova, offered to sell the Medaillon shares and the Medaillon bank debts to Nova for £30,000. The letter contained the following explanation:

> "The only asset of Medaillon and its subsidiary is a building in Offenbach owned by Medaillon and which is being offered for sale... It is impossible to give any estimate or warranty as to the net amount that may be realised on the sale of the building after repayment of [certain secured loans], but after providing for disbursements and other expenses it is thought that it may be of the order of £150,000–£200,000. on the basis that the net proceeds amounted to £150,000 this would produce the sum of approximately £55,000 towards repayment of the [bank debts]..."

The balance, namely £95,000 of the net proceeds, would be repayable to Littlewoods in part-payment of Littlewoods' advances of £4.8m to Medaillon. Thus the shares which Littlewoods had acquired for £1.5m and the bank debts which Littlewoods had acquired for £2.4m were offered to Nova for £30,000 and might produce for Nova £55,000, more or less, depending on the sale price of the building at Offenbach. Nova accepted the offer; subsequently the Medaillon shares were transferred by Littlewoods to Nova for the apportioned price of £10 and the bank debts were assigned by Littlewoods to Nova for the apportioned price of £29,990. In the result Littlewoods sustained an actual capital loss of £1,512,589 resulting from the purchase and sale of the Medaillon shares and £2,394,176 resulting from the purchase and sale of the Medaillon bank debts. For corporation tax purposes, however, the sale by Littlewoods to Nova of the Medaillon shares and Medaillon bank debts did not produce an allowable loss to Littlewoods. Section 273(1) of the Act of 1970 provides:

A "where a member of a group of companies [Littlewoods] disposes of an asset to another member of the group [Nova] both members shall ... be treated, so far as relates to corporation tax on chargeable gains, as if the asset acquired by [Nova] were acquired for a consideration of such amount as would secure that on [Littlewoods'] disposal neither a gain nor a loss would accrue to [Littlewoods];..."

B Thus for corporation tax purposes Littlewoods having acquired the Medaillon shares for £1,512,599 are deemed to have sold those shares and Nova is deemed to have purchased those shares not for the actual price of £10 but for the price of £1,512,599. Similarly Littlewoods having acquired the Medaillon bank debts for £2,424,166 are deemed to have sold those bank debts and Nova is deemed to have purchased those bank debts not for the actual C price of £29,990 but for the price of £2,424,166. If s 273 had stood alone the potential allowable loss of Littlewoods in respect of the Medaillon shares and bank debts amounting in the aggregate to £3,906,765 would simply have been transferred to and become the potential allowable loss of Nova. But if Nova, a trading company, acquired the Medaillon shares and the Medaillon bank debts as "trading stock" then Nova became in a position to convert the potential D capital allowable loss into a trading loss. By s 274(1) of the Act of 1970:

"Where a member of a group of companies [Nova] acquires an asset as trading stock from another member of the group [Littlewoods], and the asset did not form part of the trading stock of any trade carried on by [Littlewoods], the member acquiring it [Nova] shall be treated for purposes of paragraph 1 of Schedule 7 to the Finance Act 1965 as having E acquired the asset otherwise than as trading stock and immediately appropriated it for the purposes of the trade as trading stock."

As will appear, the effect of para 1 of Sch 7 of the Act of 1965 on the appropriation which Nova is deemed to make by s 274(1) of the Act of 1970 is to convert the potential allowable loss of Nova in respect of the Medaillon shares and bank debts into an actual allowable loss for corporation tax F purposes unless Nova elects to treat the loss as a trading loss. By para 1(1) of Sch 7 to the Act of 1965 as amended;

"Subject to sub-paragraph (3) below", where a trader appropriates an asset "for the purposes of the trade as trading stock...and, if he had then sold the asset for its market value, a chargeable gain or allowable loss would have accrued to him, he shall be treated as having thereby disposed G of the asset by selling it for its then market value."

Thus if sub-para (1) had applied, Nova would have been deemed to have sold the Medaillon shares and the Medaillon bank debts for £30,000 (assuming that £30,000 was the market value of the assets) after having been deemed to have purchased those assets for £3,936,765. In the result Nova would have sustained an allowable loss of £3,906,765. Sub-paragraph (3) provides that H sub-para (1) shall not apply in relation to an appropriation of an asset for the purposes of a trade if the trader

"elects that instead the market value of the asset at the time of the appropriation [£30,000] shall, in computing the profits of the trade for purposes of tax, be treated as ...increased by the amount of the allowable loss referred to in that sub-paragraph, and ..., the profits of I the trade shall be computed accordingly: ..."

Thus provided Nova in fact acquired the Medaillon shares and Medaillon bank debts as a trading stock, Nova could elect to treat Littlewoods' capital

loss of £3,906,765 as Nova's trading loss of £3,906,765 for the purposes of corporation tax. By a letter dated 15 August 1974 Nova wrote to the Inspector of Taxes referring to their acquisition of the Medaillon shares and bank debts from Littlewoods and claiming that

> "We acquired these shares and debts as trading stock, and pursuant to section 274 Taxes Act 1970, and paragraph 1(3) of Schedule 7 to the Finance Act 1965, we hereby elect that in computing the profits of the trade for purposes of tax the market value of these shares and debts shall be treated as increased by £3,906,765 the amount which would have been the amount of the allowable loss under sub-paragraph (1) of this paragraph if this election had not been made."

Thus Nova claimed to have converted an allowable loss of £3,906,765 into a trading loss of £3,906,765. It is common ground that if Nova acquired the Medaillon shares and Medaillon bank debts as trading stock, they are deemed to have made a trading loss of £3,906,765 reduced by £850 profit on other transactions during the accounting period of 6 April 1973 to 31 December 1973 to a net trading loss of £3,905,915. That trading loss is available for the group relief.

By s 258(1) of the Act of 1970, relief from trading losses:

> "may ... be surrendered by a company ... which is a member of a group of companies ... [to] ... another company ... which is a member of the same group [and] may be allowed to the claimant company by way of a relief from corporation tax called 'group relief'."

On 4 September 1975, Nova surrendered one-third of its trading loss for the accounting period ending 31 December 1973 to each of three claimant companies, members of the group of companies which included Littlewoods and Nova.

On 5 October 1979 Nova received upon the sale of the Offenbach premises the sum of £35,447.54 in part repayment of the Medaillon bank debts amounting to £2.4m. It does not appear that Nova has sold or disposed of the Medaillon shares or the Medaillon bank debts or any part of them.

The Inland Revenue resisted the claim by Nova to have sustained a trading loss of £3,905,915 for corporation tax purposes for the period ending 31 December 1973. The question is whether Nova acquired from Littlewoods the Medaillon shares and Medaillon bank debts "as trading stock" as required by s 274 of the Act of 1970. This question was referred to the General Commissioners. The Crown allowed the question to be determined not by oral evidence but on the basis of an agreed statement of facts which exhibited the relevant documents, but was wholly silent as to the reasons and intentions of Littlewoods and Nova and as to the possibility at any time of trading with the assets acquired by Nova. The Crown chose to appear before the General Commissioners by an official from the solicitors' office of the department. Nova were represented by a London firm of solicitors, junior counsel and leading counsel experienced in the field of fiscal litigation. Before the General Commissioners the onus of proving that the Medaillon shares and bank debts were acquired by Nova as trading stock lay with Nova. The General Commissioners did not deliver a reasoned decision but in their Stated Case contented themselves with finding(1):

> "as facts that the share capital and debts of Medaillon as set out in para 6 of the agreed statement of facts were acquired by Nova Securities

(1) Page 523 *ante*.

A Ltd. in the course of their trading in shares and securities and that they were acquired as trading stock. Accordingly we ... determine the assessment as profits £850 less losses £850 on the assessment as raised .... The question of law for the Opinion of the High Court is whether our decision was justified on the evidence before us."

The Crown having lost the battle before the Commissioners can only B succeed before the Court if they can show that the Commissioners committed an error of law or if they can show, pursuant to the test laid down by this House in *Edwards* v. *Bairstow*(1) [1956] AC 14, that no person, if properly instructed in the law and acting judicially, could have reached the determination of the Commissioners.

The Crown handicapped themselves by omitting to instruct counsel to C appear at the hearing before the Commissioners A similar mistake was made in *Coates* v. *Arndale Properties Ltd.*(2) [1984] 1 WLR 1328. Despite ample warnings in the past, the Crown appear to be persisting in the practice of appearing by a departmental official in cases where millions of pounds are at stake and the law is complex. In my opinion that practice should be reviewed in the interests of the general body of taxpayers.

D On appeal by the Crown by Case Stated, Walton J. [1982] STC 724(3) held that the decision of the Commissioners was correct. Nova was a company whose trade was that of dealing in shares and securities. Trading stock as defined by s 137(4) of the Income and Corporation Taxes Act 1970 means property "such as is sold in the ordinary course of the trade". The Medaillon shares and Medaillon bank debts were, therefore, trading stock. As to the E unusual features of the transaction "it is not for the revenue to tell people how they shall conduct their business" (page 731).

The Court of Appeal [1984] 1 WLR 537(4) by a majority affirmed the order of Walton J. The members of the Court of Appeal were, however, unanimously of the view that property could only be acquired "as trading stock" if it was acquired for the purpose of being used in the course of trade.

F I agree. If a company is to acquire an asset as trading stock, the asset must be not only of a kind which is sold in the ordinary course of the company's trade but must also be acquired for the purposes of that trade with a view to a resale at a profit. A company which acquired an asset for purposes other than trading would not, in my opinion, acquire the asset as trading stock even through the company habitually traded in similar assets. Thus in *Arndale's* G case, the Arndale company traded in property and acquired a lease. By a contemporaneous and pre-arranged sale, the Arndale company transferred the lease to another company in the same group. The object of these manoeuvres was to obtain the benefit of s 274, which applies to property acquired as trading stock, while ensuring at the same time that the lease was never in fact traded. Your Lordships held that *Arndale* did not acquire the lease as trading H stock.

In the instant case the members of the Court of Appeal were divided as to the result. Lawton L.J. dissenting, at page 540, would have allowed the appeal. He considered that the transaction was abnormal; the circumstances in

(1) 36 TC 207. (2) TC Leaflet 3015. (3) TC Leaflet 2904.
(4) TC Leaflet 2980.

which the agreement between Littlewoods and Nova was made were not those of normal trading; had the Commissioners viewed the transaction as a whole they could not reasonably have come to the conclusion, as they did, that Nova had acquired the Medaillon shares and the Medaillon bank debts as trading stock.

Fox L.J., at page 551, agreed that the transaction must be viewed as a whole but declined to draw the inference that the sole purpose of the acquisition by Nova was to obtain a fiscal benefit for the Littlewood group of companies. He said, at page 554([1]):

> "if the revenue wanted so fundamental a finding as that the sole or paramount purpose of the acquisition was fiscal, they should have insisted on oral evidence before the commissioners and sought a finding of fact to that effect."

Kerr L.J., at page 555, agreed with Fox L.J. and held that there was insufficient material to entitle the Court to overturn the Commissioners' finding that Nova acquired the Medaillon shares and Medaillon bank debts as trading stock. Both Lawton and Fox L.JJ. relied on the principle to be deduced from the dividend stripping cases and particularly on the decision of this House in *Lupton* v. *F.A. & A.B. Ltd.*([2]) [1972] AC 634.

In *Lupton's* case a dealer in stocks and shares purchased shares in a company worth £1.7m. The purchase price depended on the success or failure of a tax recovery claim which the purchaser undertook to make. After the purchase the purchaser received from the purchased company a dividend of £800,000 and claimed that they suffered a loss when the value of the purchased shares after payment of the dividend of £800,000 fell by £800,000. The purchaser claimed relief under s 341 of the Income Tax Act 1952 which afforded relief "where any person sustains a loss in any trade". This House held that relief was not to be granted because the object of the transaction was to obtain a fiscal advantage and the purchase did not form part of the trading activities of a dealer in stocks and shares. Viscount Dilhorne said, at page 657:

> "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 section 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 initally, but also to the manner of its implementation." Lord Simon of Glaisdale said, at page 660: "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;..."

In a dividend-stripping case, such as *Lupton's* case, an artificial loss is artificially created and the artificial transaction does not constitute trading but constitutes the manufacture of a tax advantage. In the present case Littlewoods sustained a real loss.

My Lords, the theoretical independent existence of every corporation enables a group of companies to escape liability at common law for the losses

([1]) [1984] 1 WLR 537. ([2]) 47 TC 580.

of an individual member of the group; see *In re Southard & Co. Ltd.* [1979] 1 WLR 1198 at page 1208. The theoretical independent existence of every corporation inspired a tax avoidance industry which has only partly been brought under control by the principles summarised by my noble and learned friend, Lord Brightman, in *Furniss* v. *Dawson*(1)[1984] AC 474 at page 527. Nevertheless the legislature recognising for the purpose of inflicting tax that group companies do not lead an independent existence has invented group relief which enables a group of companies to shuffle its losses between members of the group to obtain a tax advantage. The legislature has not extended group relief to allowable losses, but has conferred on a group of companies power to convert an allowable loss into a trading loss which can then be shuffled to secure a tax advantage. The Inland Revenue cannot complain that Littlewoods have secured a fiscal advantage by the statutory method presented by s 274 of the Act of 1970 and para 1 of Sch 7 to the Act of 1965. The only requirement in these circumstances is that, apart from s 274 considerations, there must be an acquisition by a trading company "as trading stock".

So far as the Medaillon bank debts are concerned, I agree with Fox L.J. [1984] 1 WLR 537, at page 554 that the Court cannot

> "conclude that no reasonable tribunal properly instructed could have decided, on the evidence, that the property was acquired by Nova 'as trading stock.'... Nova was a trading company. It bought property of a kind in which it was authorised to deal,... Before deciding to buy the property the broad of Nova considered what, in ordinary commercial terms, was the profit which Nova was likely to make on the transaction."

It is conceivable that Nova might have decided to acquire similar bank debts from a source unconnected with the group and in the hope of making a profit either by waiting until the realistion of the debts or by resale.

Different considerations apply, however, to the Medaillon shares. Medaillon's assets were valued at no more than £200,000. Medaillon's debts amounted to £8.7m. The shares were worthless. There was no commercial justification for the acquisition of the shares by Nova. There was no conceivable reason, apart from s 274, why the shares should change hands at all. In my opinion no reasonable tribunal could have concluded that the shares were acquired by Nova as trading stock.

The distinction between the Medaillon bank debts and the Medaillon shares arose in the course of argument before your Lordships. The Crown were given leave to argue the point after an adjournment of some weeks to enable Nova to consider its position. On behalf of Nova, Mr. Beattie urged that the shares were purchased as part of a package deal; Nova could not acquire the Medaillon bank debts without also acquiring the Medaillon shares. But assuming this to be so, the shares were not acquired as trading stock just because they were acquired in connection with bank debts which were so acquired.

The Medaillon shares may have been acquired in order that Nova might acquire the Medaillon bank debts as trading stock. But s 274 only applies to the shares if the shares were acquired by Nova as trading stock, namely with a

(1) 55 TC 324.

view to the resale of the shares at a profit. The shares were not commercially saleable at any price. Nova only acquired the right to share certificates which represented nothing in view of the insolvency of Medaillon and the right to be the latest and last entry in the register of a defunct company. Mr. Beattie suggested that a purchaser of the bank debts might have been willing to offer a price for the shares in order to control the disposal of the Offenbach premises. In the light of the facts and the terms of the offer letter, dates 17 August 1973, the suggestion was ingenious but fanciful.

In the circumstances in my opinon the assessment made on Nova for the accounting period 6 April 1973 to 31 December 1973 on the basis of a trading profit of £850 should remain discharged. The claims to group relief, however, based on the trading loss of £3,906,765 sustained as a result of the acquisition of the Medaillon bank debts and the Medaillon shares ought only be allowed on the basis of a trading loss of £2,394,176 based on the acquisition of the Medaillon bank debts as trading stock. On this appeal the order of Walton J. should be varied and the question posed by the Stated Case should be answered by declaring that the decision of the Commissioners was justified in respect of the acquisition by Nova of the Medaillon bank debts but not in respect of the acquisition of the Medaillon shares.

In view of the failure of the Crown to differentiate between the shares and the bank debts until a late stage, I suggest that the order of the Courts below with regard to costs should stand and that there should be no order for the costs of the appeal to your Lorships' House.

Appeal allowed in part. No order as to costs.

[Solicitors:—Messrs Allen & Overy; Solicitor of Inland Revenue.]