A COURT OF SESSION (FIRST DIVISION)—18TH AND 22ND FEBRUARY 1966

HOUSE OF LORDS—12TH JANUARY AND 23RD FEBRUARY 1967

Commissioners of Inland Revenue *v.* Brebner[1]

B *Surtax—Tax advantage—Counteraction—Capitalisation of profits by company followed by reduction and repayment of capital—Funds required to finance offer in opposition to takeover bid—Whether bona fide commercial transactions—Whether tax advantage a main object—Finance Act* 1960 (8 & 9 *Eliz.* 2, *c.* 44), *s.* 28.

The Respondent was a director of, and shareholder in, a company carrying C *on business as coal merchants. In* 1959 *a takeover bid was made for the company, which if successful was likely to put an end to the business. Most of the directors, including the Respondent, had interests in fishing companies, which received favourable terms from the company and would be in difficulties about coal for their coal-burning ships if it ceased to operate. The Respondent and five others therefore made a successful counter-offer, at a price based not on the company's* D *earning capacity but on the need to defeat the original offer. The money was advanced by a bank on condition of early repayment. Consequently, a scheme was prepared by the company's auditors whereby in December* 1960 *the company resolved to increase its paid-up share capital from* £60,000 *to* £135,000, *by capitalising* £16,527 *from capital reserve and* £58,473 *from revenue reserve, and then to reduce its capital to* £60,000 *and repay the balance to the shareholders.* E *The reduction of capital having been confirmed by the Court, the Respondent and his associates applied the sums received by them in reducing their loans from the bank.*

The Commissioners of Inland Revenue gave notice to the Respondent under s. 28, *Finance Act* 1960, *that the adjustment requisite to counteract the tax advantage was that his liability to surtax for the year* 1960–61 *should be computed* F *on the basis of treating* 58,473/75,000 *of the sum received by him as the net amount of a dividend payable under deduction of tax at the date of receipt. On appeal, the Special Commissioners found that the transactions in question were entered into for bona fide commercial reasons and did not have as one of their main objects to enable tax advantages to be obtained.*

Held, *that there was ample evidence on which the Commissioners could find* G *as they did.*

CASE

I. At meetings of the Commissioners for the Special Purposes of the Income Tax Acts held at Turnstile House, High Holborn, London, on 15th and 16th June 1964 for the purpose of hearing appeals, William Brebner (hereinafter H called "the Respondent") appealed against a notice dated 12th December 1963, given by the Commissioners of Inland Revenue under the provisions of s. 28(3) of the Finance Act 1960.

II. A copy of this notice is annexed hereto, marked "A", and forms part of this Case.

I [1] Reported (C.S.) 1966 S.L.T. 208; (H.L.) [1967] 2 A.C. 18; [1967] 2 W.L.R. 1001; 111 S.J. 216; [1967] 1 All E.R. 779.

The Aberdeen Coal & Shipping Co. Ltd. is hereinafter referred to as "the company". A

III. The Commissioners of Inland Revenue had issued five other notices referring to transactions similar to those set out in the notice to the Respondent. These notices were addressed to:—Malcolm Smith, John N. Stephen, Andrew W. King, Alexander Hay, and Charles F. Graham. The Respondent and Messrs. Stephen, King and Hay were directors of the company at 22nd February 1959. Mr. Malcolm Smith, who is now dead, and Mr. Graham became directors on 6th April 1959. B

The Respondent and the above-named five persons are hereinafter referred to as "the group".

IV. We heard the appeal of Mr. Graham against his notice together with the Respondent's appeal. C

V. Shortly stated, the question for our decision was whether s. 28 did not apply to the transactions in question because they were carried out for *bona fide* commercial reasons and none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained.

It was admitted on behalf of the Respondent that there had been a transaction in securities, within the meaning of s. 28(1)(*b*), and that a tax advantage had been obtained. D

VI. The Respondent gave evidence before us: he has been a director of the company since 1952.

The following gave evidence before us on behalf of the Respondent: Steven Leslie Henderson: he is a Chartered Accountant and a partner in the firm of G. and J. McBain, of Aberdeen, auditors to the company; Charles F. Graham: he has been a shareholder in the company since 1950, when he took over his father's shares, his father having then been a shareholder for over 40 years; as already mentioned (para. III above), he became a director on 6th April 1959. E

VII. The following facts were proved or admitted before us.

(1) The company was incorporated in 1900, and carried on the business of coal merchants. It was a public company, and its shares were quoted on the Aberdeen stock exchange until 14th April 1960. Its issued capital up to the date of the transactions in question was £60,000, divided into 60,000 shares of £1 each. There were a large number of shareholders, but the members of the group were the largest individual shareholders. It had had one ship, the "S.S. Redhall", used for carrying coal, but some short time before 22nd February 1959 it had bought a diesel collier, "Moray Firth", to replace the Redhall. F G

(2) In January 1959 the Respondent met a Mr. Scott-Sutherland, who was an architect and a director of a company called Bydand Industrial Holdings Ltd. ("Bydand"). It became apparent that Mr. Scott-Sutherland was contemplating a takeover bid, and he asked if the company had got its new ship yet. The Respondent said that it had, although at that date the company was still negotiating to buy it; for he gained the impression that the bid would not materialise if the company had in fact bought a new ship. He told Mr. Scott-Sutherland that he would not succeed in taking over the company. H

(3) The Respondent, for reasons which will appear later, was most anxious to preserve the company at all costs, and he immediately went to see a Mr. Wood, the manager of the Aberdeen branch of the British Linen Bank, and asked him about the prospects of financial help. Mr. Wood said he thought he would be able to help. I

(4) On 21st February 1959 the Respondent received Bydand's offer, which had been sent to all the company's shareholders, to purchase the shares in the company at a price of 40*s.* 6*d.* per share. A copy of this offer is annexed hereto, marked "B", and forms part of this Case(1).

(5) Bydand's offer was discussed at a meeting of the company's board of directors on 22nd February 1959. (The Respondent and Messrs. Stephen, King and Hay were directors at that date.). By this date the directors had good reason to fear, and did fear, that Mr. Scott-Sutherland intended to break up the company if Bydand's offer was accepted, and the board thought that this intention appeared pretty clearly in the condition in the offer that there was no commitment of the company for the purchase or long-term charter of a vessel.

(6) At this board meeting on 22nd February 1959 the directors were unanimous that they could not allow the company to be broken up. Most of the directors, including the Respondent, had interests in fishing companies, who received favourable terms from the company, and these companies would be in difficulties about coal for their coal-burning ships if the company ceased to operate. Moreover, the company was a happy one, with good relations with its employees, who would lose their jobs if Bydand's takeover bid was successful.

(7) It was decided at this board meeting on 22nd February 1959 that the only way to defeat the takeover attempt was to make a counter-offer, although at this stage the price to be offered for shares and the method of raising the necessary finance had not been considered.

Messrs. Malcolm Smith and Graham, who were entirely of the same mind as the directors, were approached—hence the formation of the group.

(8) Mr. James Robb, the chairman of the board, sent a letter to all shareholders, dated 22nd February 1959, a copy of which is annexed hereto, marked "C", and forms part of this Case(1). Although at this time the market price of the company's shares was about 25*s.*, it was true that the break-up value of the company's assets was more than 40*s.* 6*d.* per share, and that the prospects of continuing to make profits were good. Similar comments would have applied to an offer of 42*s.* 6*d.* per share: the significance of the figure of 42*s.* 6*d.* appears later.

(9) As a result of the decisions taken at the board meeting of 22nd February 1959 and of the approach to Messrs. Malcolm Smith and Graham, the group entered into an agreement between all its members on 26th February 1959, a copy of which is annexed hereto, marked "D", and forms part of this Case(1).

(10) The group having been formed in the circumstances described in sub-para. (7) above, Messrs. Stephen and Graham sent a letter to all shareholders, dated 27th February 1959, a copy of which is annexed hereto, marked "E", and forms part of this Case(1).

A copy of the offer referred to in this letter, is annexed hereto, marked "F", and forms part of this Case(1).

(11) To interrupt the chronological order of events. Shortly after the receipt by Mr. Graham of Bydand's offer of 20th February 1959, but before the group's offer of 27th February 1959 (referred to in sub-para. (10) above), Mr. Graham had met a Mr. Christie, of John Lewis & Son. Mr. Christie asked Mr. Graham if he would accept an offer of 42*s.* 6*d.* per share for his shares; Mr. Graham said he was doubtful whether he would accept this offer, but he would contact the company's board, which he did. Later Mr. Lewis himself attended a board meeting of the company and said that Mr. Christie's offer had not been authorised, and no formal offer by John Lewis & Son was ever made.

(1) Not included in the present print.

John Lewis & Son were in a line of business similar to that of the company. It seemed probable that if John Lewis & Son had taken over the company they would have incorporated the company's business with their own and sold its buildings, and would not have given the other companies in which the directors and Mr. Graham were interested the same credit terms as the company was giving; had they undertaken to do so, a formal offer might have been accepted by the group.

In view of this tentative offer of 42*s*. 6*d*. per share the group did not consider an offer a few pence higher was worth while: such an offer might spur Bydand or John Lewis & Son to a still better offer, and it was for this reason that the group decided to offer 45*s*. per share.

This figure of 45*s*. was not based on the earning capacity of the company. The Respondent thought it was too high, but he personally would have been prepared to offer more in his determination to preserve the company if possible.

(12) The group's offer of 45*s*. per share, which was accepted by nearly all the shareholders, involved them in a total expenditure of £108,000 (£18,000 each). This money they had to borrow from the British Linen Bank, and the bank insisted on a joint and several undertaking by the group's members, with a clause providing for early repayment.

(13) It had been understood from the beginning by the members of the group that their repayments to the bank were to be effected as far as possible by taking assets out of the company, but at this early stage there had been no calculation as to how much cash could be extracted from the company, and the figure of 45*s*. per share was not based on any such calculation.

(14) As appears from the notice under appeal (exhibit A), the amount of cash which was eventually extracted from the company was £75,000, made up of £16,527 7*s*. 8*d*. standing to the credit of capital reserve (which was in fact available for distributions by way of capital dividend) and £58,472 12*s*. 4*d*. part of the sum standing to the credit of revenue reserve account (which represented an accumulation of taxed profits).

To have declared a dividend of £75,000 would have been a very astonishing thing indeed for a company of this size; moreover, with the liability to surtax involved on the surtaxable part of the dividend, the dividend would not have provided the finance the group wanted for the repayment of their indebtedness to the bank, and the declaration of such a dividend was something the group never contemplated. Nor did the group ever contemplate borrowing £75,000 from the company at interest.

(15) With the object, therefore, of obtaining money from the company to finance the repayment of the group's loans from the bank, the Respondent instructed Mr. Henderson to prepare a scheme involving the liquidation of the company and the formation of a new company.

This Mr. Henderson did, and a copy of this scheme is annexed hereto, marked "G", and forms part of this Case([1]).

In preparing this scheme Mr. Henderson considered the question whether a direction might be made under s. 245 of the Income Tax Act 1952 (surtax on companies), and came to the conclusion that this was very unlikely. This scheme was considered by the company's board of directors, but was found to be impracticable. After the group had acquired the bulk of the shares the directors' fees were increased and the dividends reduced in order to induce the

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

A few remaining minority shareholders to sell out. They did not do so, however, and the continued presence of an outside minority was considered to make the liquidation scheme impracticable.

Mr. Henderson prepared a second scheme, also involving liquidation, but it was never considered by the board.

(16) Mr. Henderson prepared a third scheme, which was adopted, and it is B the one set out in the notice under appeal.

Mr. Henderson's final instructions were to prepare a third scheme whereby it would be unnecessary to pay out any substantial sum to the smaller shareholders. The first step was to find the maximum cash which the company could part with, and secondly to take this cash out in the form of a repayment of capital. Mr. Henderson in preparing the scheme of course appreciated that a C distribution of the company's surplus cash by way of dividend would have left (after surtax) a smaller net sum for payment to the bank, but quite apart from this he regarded the method used as the natural one in the circumstances and he did not consider that any tax considerations applied to the preparation of the third scheme.

The group adopted the third scheme as prepared by Mr. Henderson D without discussing any alternatives. The Respondent in particular was content to leave the question of method to the accountant.

(17) This scheme was embodied in a petition to the Court of Session, and a copy of the petition is annexed hereto, marked "H", and forms part of this Case[1]. The petition sets out, in paras. 7, 10 and 11 thereof, the company's financial position, so far as is relevant, and also the special resolutions necessary E to implement the scheme.

(18) The repayment of capital sanctioned by the Court of Session was made on 10th March 1961, and the group immediately used their repayments to reduce their loans from the bank. The bank thereupon released the members of the group from their joint and several undertaking to repay.

The members of the group made further reductions from time to time in F their individual indebtedness from directors' fees and dividends from their shares in the company.

(19) There is annexed hereto, marked "I", and forming part of this Case[1], a table showing the dividend income received, and the bank interest paid, by each of the group for the years 1960–61 and 1961–62.

No evidence was before us that any consideration was given by any G member of the group to any scheme for discharging or reducing his overdraft by realising his other investments.

(20) There is annexed hereto, marked "J", and forming part of this Case[1], a document showing that, on the basis of Mr. Henderson's valuation of the company's shares after the reduction, as a result of the scheme the net assets of each member of the group increased by £1,200.

H (21) The Respondent and all the other members of the group were mainly concerned, by the acquisition of additional shares, to preserve the company in the line of business which it had carried on for many years; a business, moreover, which had good prospects of continuing profitably.

The third scheme was adopted as the most satisfactory method of raising the money necessary for the purchase of the additional shares.

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[1] Not included in the present print.

VIII. On behalf of the Respondent two contentions were put forward formally for the purpose of keeping them open: A

(1) that the words "so receives" in s. 28(2)(*d*) were an echo of the word "receives" in the opening sentence of s.28(2)(*c*);

(2) that s. 28(2)(*d*) referred to two separate matters, distribution of profits and consideration; it did not apply where, as in the present case, the consideration was itself the distribution of profits. B

IX. The Respondent's main contentions were:

(1) that the transactions in question had been carried out for *bona fide* commercial reasons, i.e., the preservation of the company as a profitable going concern;

(2) that the transactions in question did not have as their main object, or one of their main objects, to enable tax advantages to be obtained; C

(3) that any tax advantage that was obtained was ancillary to the main *bona fide* commercial reasons.

X. As regards the Respondent's contentions in para. VIII, it was contended on behalf of the Commissioners of Inland Revenue that the words "so receives" in s. 28(2)(*d*) referred to those words in the phrase "so receives the consideration . . ." at the end of s. 28(2)(*c*), and that the contention in para. VIII(2) was wrong. D

XI. The main contentions of the Commissioners of Inland Revenue were:

(1) that the onus was on the Respondent to show that the transactions in question had been entered into for *bona fide* commercial reasons and that they did not have as their main object, or one of their main objects, to enable tax advantages to be obtained; E

(2) that if there were *bona fide* commercial reasons for the acquisition of all the company's shares by the group (which was not admitted), the transactions in question were not the inevitable consequence of the decision to acquire those shares; therefore the transactions themselves were not entered into for *bona fide* commercial reasons;

(3) that if one of the main objects of the transactions was to extract cash from the company in the form of capital and not of income liable to surtax, one of the main objects of the transactions must have been to enable tax advantages to be obtained; F

(4) that the Respondent had not discharged the onus on him referred to in sub-para. (1) above.

XII. We, the Commissioners who heard the appeal, gave our decision as follows: G

As we had come to a conclusion on the Respondent's main contentions and the contentions set out in para. VIII above had not been fully argued, we thought it unnecessary to give a decision on them.

On a consideration of all the evidence before us we found that the transactions in question had been entered into for *bona fide* commercial reasons. We also found that, though admittedly a tax advantage had been obtained, this advantage was an ancillary result of the main object, which was a *bona fide* commercial one, and that the transactions in question did not have as their main object, or one of their main objects, to enable tax advantages to be obtained. H

We discharged the notice under appeal.

XIII. The Commissioners of Inland Revenue immediately after the determination of the appeal declared to us their dissatisfaction therewith as being erroneous in point of law, and in due course required us to state and sign a Case for the opinion of the Court of Session as the Court of Exchequer in Scotland, which Case we have stated and signed accordingly.

XIV. The question of law for the opinion of the Court is whether we were right in finding on the evidence before us as we did.

R. W. Quayle
G. R. East
} Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94–99 High Holborn,
London, W.C.1.
4th February 1965.

EXHIBIT "A"

To: William Brebner, Esq.,
29 Cults Avenue,
Cults, Aberdeenshire.

Section 28, Finance Act, 1960

Whereas, on the 25th April 1963, the Commissioners of Inland Revenue issued a notification to you, in accordance with subsection (4) of Section 28 of the Finance Act, 1960, that they had reason to believe that the said Section 28 (which relates to the cancellation of tax advantages from certain transactions in securities) might apply to you in respect of the following transactions, that is to say:

1. the resolution of The Aberdeen Coal and Shipping Company Limited (hereinafter called "the Company") on 22nd December 1960, to capitalise the sum of £75,000 being as to £16,527. 7. 8 the amount standing to the credit of the capital reserve and as to £58,472. 12. 4 part of the amount standing to the credit of the revenue reserve account, and to apply the said sum in paying up in full at par 75,000 ordinary shares of £1 each to be alloted and distributed credited as fully paid, to the holders of the ordinary shares in the Company in proportion to their holdings on that date;
2. the allotment to you of 12,445 of the said 75,000 ordinary shares credited as paid up as aforesaid, pursuant to the said resolution;
3. the resolution of the Company on 22nd December 1960, that the capital of the Company be reduced from £135,000 divided into 135,000 shares of £1 each to £60,000 divided into 135,000 shares of 8s. $10\frac{2}{3}$d. each and that such reduction be effected by returning to the holders of the said shares paid-up capital to the extent of 11s. $1\frac{1}{3}$d. per share and by reducing the nominal amount of each of the said shares from £1 to 8s. $10\frac{2}{3}$d., the said reduction being confirmed by an Order of the Court of Session dated 9th March 1961, which Order was registered by the Registrar of Companies on 14th March 1961;
4. the payment of £12,445 to you on 10th March 1961, by way of return of 11s. $1\frac{1}{3}$d. per share on the 22,401 ordinary shares held by you, pursuant to the last-mentioned resolution of the Company;
5. the resolution of the Company on 22nd December 1960, that upon such reduction of capital taking effect the 135,000 shares of 8s. $10\frac{2}{3}$d. each be

consolidated in such a manner that every nine of the said shares shall constitute four £1 shares upon each of which the sum of £1 shall be credited as having been fully paid.

And whereas you have not exercised (within the time limited therefor) the right under the said subsection (4) to make a statutory declaration to the effect that the said Section 28 does not apply to you in respect of the said transactions:

Now therefore the Commissioners of Inland Revenue, being of opinion that Section 28 of the Finance Act, 1960, applies to you in respect of the aforesaid transactions, hereby give notice, in accordance with subsection (3) of that Section, that the following adjustments are requisite for counteracting the tax advantage thereby obtained or obtainable, that is to say, the computation or recomputation of your liability to surtax for the year of assessment 1960–61 on the basis that £9,702, being $\frac{\text{£58,472. 12. 4}}{\text{£75,000. 0. 0}}$ of the payment of £12,445 referred to in 4. above should be taken into account as if it were the net amount received in respect of a dividend payable at the date of the receipt thereof from which deduction of tax was authorised by subsection (1) of section 184 of the Income Tax Act, 1952, and any assessment or additional assessment to surtax which may be requisite to give effect to such computation or recomputation.

Dated this 12th day of December 1963
By Order of the Commissioners of Inland Revenue
Assistant Secretary

Inland Revenue,
Somerset House,
London, W.C.2.

The case came before the First Division of the Court of Session (the Lord President (Clyde) and Lords Guthrie, Migdale and Cameron) on 18th February 1966, when judgment was reserved. On 22nd February 1966 judgment was given unanimously against the Crown, with expenses.

J. Mackay Q.C. and *C. K. Davidson* for the Crown.

Hon. H. S. Keith Q.C. and *G. L. Cox* for the taxpayer.

Parker v. *Commissioners of Inland Revenue*, page 396 *ante;* [1966] A.C. 141 was cited in argument.

The Lord President (Clyde)—This case arises out of a notice served on the Respondent and on others under s. 28 of the Finance Act 1960, in respect of certain transactions entered into in connection with the long- and short-term financing of arrangements to defeat a threatened takeover bid of a company in which they were interested as shareholders and as directors.

In terms of s. 28(1) of this Act, where a person has obtained a tax advantage from certain defined transactions, the tax advantage will be cancelled unless the person who has obtained the advantage shows that the transaction or transactions were carried out either for *bona fide* commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable a tax advantage to be obtained. After a hearing the Special Commissioners came to the conclusion on the evidence that, although admittedly a tax advantage had been obtained, yet the transactions in question had been entered into for *bona fide* commercial reasons. They also found that this tax advantage was an ancillary result of the main object, which was a *bona fide* commercial one, and that the transactions in question did not have as their main object or one of their

main objects to enable tax advantages to be obtained. They therefore discharged the notice under appeal. The question before us is whether they were right in finding on the evidence as they did. The issue raised in the Case is a pure question of fact, and from the facts found proved by the Special Commissioners there was ample evidence on which they could find as they did. The question which the Special Commissioners had to determine was what was the object in the mind of the Respondent in entering into the transactions in question, and this is essentially a matter of fact and of inference for the Commissioners.

Conscious, no doubt, of the difficulties of attacking the conclusion reached by the Special Commissioners, the Crown sought to isolate one transaction from the series of interrelated transactions adopted to solve the financial difficulties which the defeat of the takeover bid had created, and by regarding this one transaction in isolation to contend that the only explanation of it was that it achieved avoidance of tax. The transaction which the argument sought to isolate from its context was a decision of the company to capitalise certain of its reserves and to apply the resulting capital sum in paying up in full ordinary shares which were allotted to the shareholders, including the Respondent. There is no doubt that this transaction did result in a tax advantage to the shareholders, including the Respondent, but that is not the issue in this case. The material question is not what was the effect of each or all of the interrelated transactions; the question is what was the main object or objects for which any of them was adopted. Section 28(1) of the Act draws a clear distinction between effect and object. It was to this latter question that the Special Commissioners rightly directed their attention. To do so they had to consider each particular transaction in the series in its proper setting. So viewing the matter, they not only negatived the suggestion that the Respondent's object was to secure a tax advantage but they found in fact that

> "the Respondent and all the other members of the group were mainly concerned by the acquisition of additional shares to preserve the company in the line of business which it had carried on for many years; a business, moreover, which had good prospects of continuing profitably."

The scheme which was adopted and of which the transaction in question was an integral part was prepared at their request by the auditor of the company in order to achieve their object. The Respondent was content to leave the method of so doing to the auditor, and so far as appears no question of securing a tax advantage was ever a factor which they took into account. The object was a *bona fide* commercial one in which tax considerations played no part.

In my opinion this is a very clear case, and no ground has been made out for holding that the Special Commissioners erred in arriving at their conclusion. The question should therefore be answered in the affirmative.

Lord Guthrie—I agree.

Lord Migdale—I also agree.

Lord Cameron—Concurred.

The Crown having appealed against the above decision, the case came before the House of Lords (Lords Reid, Morris of Borth-y-Gest, Hodson, Pearce and Upjohn) on 12th January 1967, when judgment was reserved. On 23rd February 1967 judgment was given unanimously against the Crown, with costs.

J. Mackay Q.C. (of the Scottish Bar), *J. Raymond Phillips* (of the English Bar) and *C. K. Davidson* (of the Scottish Bar) for the Crown. A

H. H. Monroe Q.C. (of the English Bar) and *D. A. Shirley* (of the English Bar) for the taxpayer.

Commissioners of Inland Revenue v. *Parker*, page 396 *ante*; [1966] A.C. 141 was cited in argument in addition to the case referred to in Lord Upjohn's speech. B

Lord Reid—My Lords, I have read the speech of my noble and learned friend Lord Upjohn. I agree with it and have nothing to add. I would, therefore, dismiss this appeal.

Lord Morris of Borth-y-Gest—My Lords, I concur.

Lord Hodson—My Lords, I concur. C

Lord Pearce—My Lords, the issue before the Special Commissioners was a question of fact. It is argued by the Crown that, as a matter of law, on a proper analysis of s. 28(1) of the Finance Act 1960, nobody could, on the evidence, have reasonably come to the conclusion which they reached. I cannot accept this argument. The Commissioners rightly approached the transaction as a whole from a broad commonsense view, and there was ample evidence to D justify their findings.

It was argued that their approach should have been more analytical; that they should have isolated the later part of the transaction from the earlier; and that the actual resolutions which finally obtained the tax advantage must have had as their main object the tax advantage since it was to that alone that they (in isolation) were referable. Moreover, it was argued, the object E which was under consideration was the object of the company as such and not of its directors or shareholders, and the company, being indifferent to how its assets were distributed, cannot have a *bona fide* commercial reason or any reason other than a tax advantage. But, in my opinion, such analysis and isolation would be wrong and would destroy the opportunity of arriving at a just and sensible conclusion which the subsection was intended to provide. F

The complete series of events set out in the Case Stated was, in the view of the Special Commissioners, one consecutive whole.

> "The Respondent and all other members of the group were mainly concerned, by the acquisition of additional shares, to preserve the company in the line of business which it had carried on for many years; a business, moreover, which had good prospects of continuing profitably." G

The money had to be borrowed from the bank by members of the group with a clause providing for early repayment. And

> "It has been understood from the beginning by the members of the group that their repayments to the bank were to be effected as far as possible by taking assets out of the company, but at this early stage there had been no calculation as to how much cash could be extracted H from the company, and the figure of 45*s.* per share was not based on any such calculation."

The resulting transaction was prepared by their auditor to carry out their main purpose.

It would be quite lacking in reality to draw a line between the first part of the arrangement, namely, the purchase of the shares on a short-term overdraft, I and the second part of the arrangement whereby the overdraft was repaid, as

(Lord Pearce)

A initially arranged, largely out of the surplus assets of the company. The first part of the arrangement had committed them to the second part, whereby the whole original scheme was to be implemented. Unless they abandoned the whole scheme (by selling the shares to somebody who would probably wind up the company) they had to go on with it.

The "object" which has to be considered is a subjective matter of intenB tion. It cannot be narrowed down to a mere object of a company, divorced from the directors who govern its policy or the shareholders who are concerned in and vote in favour of the resolutions for the increase and reduction of capital. For the company, as such, and apart from these, cannot form an intention. Thus the object is a subjective matter to be derived in this case from the intentions and acts of the various members of the group. And it C would be quite unrealistic and not in accordance with the subsection to suppose that their object has to be ascertained in isolation at each step in the arrangements.

Admittedly, an object of the carrying out of the broad scheme by way of the resolutions was a tax advantage. But that which had to be ascertained was the object (not the effect) of each interrelated transaction in its actual D context, and not the isolated object of each part regardless of the others. The subsection would be robbed of all practical meaning if one had to isolate one part of the carrying out of the arrangement, namely, the actual resolutions which resulted in the tax advantage, and divorce it from the object of the whole arrangement. The method of carrying it out was intended as one part of a whole which was dominated by other considerations. As the learned Lord E President (Clyde) said[1]:

> "The material question is not what was the effect of each or all of the interrelated transactions; the question is what was the main object or objects for which any of them was adopted. Section 28(1) of the Act draws a clear distinction between effect and object. It was to this latter question that the Special Commissioners rightly directed their attention. F To do so they had to consider each particular transaction in the series in its proper setting."

For those reasons, I am of opinion that the Special Commissioners came to a reasonable conclusion on the evidence before them. They could have reached a contrary conclusion, which would have been equally unassailable, had they taken a different view of the evidence. But it was they who heard G the witnesses, and I see no reason to suppose that their decision was not just and sensible. I entirely agree with the judgment of the Lord President.

I would dismiss the appeal.

Lord Upjohn—My Lords, this appeal from an Interlocutor of the First Division of the Court of Session as the Court of Exchequer in Scotland dated 22nd February 1966 is concerned with the short question, whether the Special H Commissioners of Income Tax were entitled to discharge a notice dated 12th December 1963, served upon the Respondent by the Commissioners of Inland Revenue under s. 28(3) of the Finance Act 1960. This depends entirely upon the words of that section, so that I must set out its relevant parts.

> "*Cancellation of tax advantages from certain transactions in securities.* 28.—(1) Where—(*a*) in any such circumstances as are mentioned in the I next following subsection, and (*b*) in consequence of a transaction in

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(1) *See* page 713 *ante*.

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> securities or of the combined effect of two or more such transactions, a person is in a position to obtain, or has obtained, a tax advantage, then unless he shows that the transaction or transactions were carried out either for bona fide commercial reasons or in the ordinary course of making or managing investments, and that none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained, this section shall apply to him in respect of that transaction or those transactions."

It is unnecessary to refer to the following subsections, for they do not enter into the question before your Lordships.

It was admitted on behalf of the Respondent that there had been a transaction or transactions in securities within the meaning of s. 28(1)(*b*) and that, as a result, a tax advantage had been obtained.

The only question, therefore, as stated in para. V of the Case stated by the Special Commissioners, was

> "whether s. 28 did not apply to the transactions in question because they were carried out for *bona fide* commercial reasons and none of them had as their main object, or one of their main objects, to enable tax advantages to be obtained."

The facts are set out in full in the Case Stated, and I only recapitulate some of the leading features for the reason that the only question that your Lordships have to consider is whether upon the primary facts the Special Commissioners were entitled to draw the inferences of fact and to reach the conclusion which in fact they did, or whether their conclusions were reached without any evidence to support them.

So, very briefly, I must state that the Aberdeen Coal & Shipping Co. Ltd. (to which I shall refer as "the company) was incorporated in 1900 and carried on the business of coal merchants. It was, until the transaction presently to be mentioned, a public company with shares quoted on the Aberdeen stock exchange. Its capital was £60,000 divided into shares of £1 each, and there were a large number of shareholders. But the Respondent and five other shareholders were the principal and main shareholders ("the group"). In 1959 there was in the air what is normally called a "takeover bid" from an outside source, and an offer was made to all the company's shareholders to purchase the shares in the company at a price of 40*s.* 6*d.*, although the market price was only 25*s.* The Respondent was one of the directors of the company, and at a board meeting on 22nd February 1959 the directors were unanimous that they could not allow it to be taken over and then, as they feared, broken up, for the reasons that most of the directors had interests in fishing companies which received favourable terms from the company with regard to the supply of coal and they would be in difficulties about coal for their coal-burning ships if the company ceased to operate; but, further, the company was a happy one with good relations with its employees, who would lose their jobs if the outside takeover bid was successful. So it was decided at this board meeting that the only way to defeat the takeover attempt was to make a counter-offer, although at that stage the price to be offered for the shares and the method of raising the necessary finance had not been considered.

Ultimately the Respondent and his group offered all shareholders to purchase their shares at 45*s.* per share. This was not based on the earning capacity of the company, and the Respondent himself thought it was too high, but the group settled on this price in the light of another possible offer

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A of 42*s.* 6*d.* per share from another outside party; further, the Respondent was most anxious to preserve the company if possible. This offer was accepted by nearly all the shareholders. This involved the group in a total expenditure of £108,000, or about £18,000 each. They borrowed this from the British Linen Bank. The bank insisted on a joint and several undertaking by the group's members with a clause providing for early repayment. It was understood from B the beginning by the members of the group that their repayments to the bank were to be effected as far as possible by taking assets out of the company, but at this early stage there had been no calculation as to how much cash could be extracted from the company, and the figure of 45*s.* per share was not based on any such calculation. Putting it very briefly, the company had ample cash resources of about £75,000, part of which, as to £16,500, could have been C declared as a capital dividend and the balance, as to £58,500, could have been distributed as an ordinary dividend. However, as the Special Commissioners held, to declare a dividend of £75,000 would have been a very astonishing thing indeed for a company of this size and, with the liability to surtax on the surtax-able part of the dividend, it would not have provided the required finance for repayment of the bank loan; so this was never contemplated. Nor did the D group ever contemplate borrowing £75,000 from the company at interest. The Respondent, who appears to have been conducting matters on behalf of the group, with a view to extracting the necessary money instructed Mr. Henderson, the accountant to the company, to prepare a scheme involving the liquidation of the company and the formation of a new company. This was done, but was found by the directors to be impracticable. Had it been practicable to extract E the cash in this way it was conceded that it would not have been taxable under s. 28. A second scheme was stillborn, but the third scheme, which was adopted and is the one which your Lordships have to consider, was that by a scheme of reconstruction sanctioned by the Court of Session in March 1961 the capital of the company was increased to £135,000 by capitalising the available sum of £75,000 and then reduced by repaying to shareholders such a sum as was F necessary to put the sum of £75,000 into their pockets.

This return of capital was used by members of the group to reduce the loans they had received from the British Linen Bank for the purchase of the shares of the minority shareholders. The Special Commissioners found as a fact that the Respondent and all other members of the group were mainly concerned, by the acquisition of additional shares, to preserve the company G in the line of business it had carried on for many years; a business, moreover, which had good prospects of continuing profitably.

Upon the whole of this evidence the Special Commissioners came to the conclusion:

> "On a consideration of all the evidence before us we found that the transactions in question had been entered into for *bona fide* commercial reasons. We also found that, though admittedly a tax advantage had been obtained, this advantage was an ancillary result of the main object, which was a *bona fide* commercial one, and that the transactions in question did not have as their main object, or one of their main objects, to enable tax advantages to be obtained."

As I have said earlier, the sole question for your Lordships is whether that I finding was made without any evidence to support it.

My Lords, that finding has been attacked upon this ground. It is said that the transaction which I have briefly narrated must be divided into two chapters. The first chapter dealt with the transaction down to the acceptance

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of the group's offer of 45*s.* per share in March 1959, when it was recognised, A
though no plans were made, that to implement that offer the group must rely upon, and extract, the cash lying in the company's coffers. As I understood the argument, down to the conclusion of this chapter, the Respondent or his group would escape the net cast by s. 28. It was then said that a second chapter opened and that the group then arranged that the available money for the payment of this project should be obtained from the coffers of the company B
as capital. Thus, by reason of a perfectly proper scheme of arrangement, but nearly two years later, the main object of the operation in this chapter was to enable a tax advantage to be obtained because, although it would have been possible to extract the cash from the company by a dividend (subject of course to the surtax consequences as to £58,500 of that dividend), the whole object of the reduction of capital was to extract the cash without paying tax; that, it C
was strongly urged, showed it to be a main object. So, the argument proceeds, while the first chapter was carried out for purely *bona fide* commercial reasons without having as a main object the gain of a tax advantage, it must be regarded as purely introductory to the all-important second chapter two years later, when the scheme was devised to extract the cash by a reduction rather than the declaration of a dividend, so that it became plain that one of the main objects D
of the transaction was to enable a tax advantage to be obtained. Accordingly, the transaction fell within s. 28(1)(*b*). Counsel for the Respondent has, in my view, wisely conceded that the Special Commissioners could have found that there were two separate chapters, one of which was purely commercial, the other of which had as its main object the obtaining of a tax advantage. But this, he has urged, is a matter which must be entirely one for the Commissioners. E
I agree the question whether one of the main objects is to obtain a tax advantage is subjective and, as Lord Greene M.R. pointed out in *Crown Bedding Co. Ltd.* v. *Commissioners of Inland Revenue* (1946) 34 T.C. 107, at pages 115 and 117, is essentially a task for the Special Commissioners unless the relevant Act has made it objective (and that is not suggested here).

My Lords, in the First Division Lord President Clyde, delivering the first F
judgment, with which the other Lords of Session agreed, put it in a nutshell, when he said[1]:

> "The issue raised in the Case is a pure question of fact, and from the facts found proved by the Special Commissioners there was ample evidence on which they could find as they did. The question which the Special Commissioners had to determine was what was the object in G
> the mind of the Respondent in entering into the transactions in question, and this is essentially a matter of fact and of inference for the Commissioners."

With this I wholly agree.

My Lords, I would only conclude my judgment by saying, when the question of carrying out a genuine commercial transaction, as this was, is H
considered, the fact that there are two ways of carrying it out—one by paying the maximum amount of tax, the other by paying no, or much less, tax—it would be quite wrong as a *necessary* consequence to draw the inference that in adopting the latter course one of the main objects is, for the purposes of the section, avoidance of tax. No commercial man in his senses is going to carry out commercial transactions except upon the footing of paying the smallest I
amount of tax involved. The question whether in fact one of the main objects

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[1] *See* page 713 *ante*.

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A was to avoid tax is one for the Special Commissioners to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence.

For these reasons I would dismiss this appeal.

Questions put:

That the Interlocuter appealed from be recalled.

B *The Not Contents have it.*

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

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue (England), for Solicitor of Inland Revenue (Scotland); William A. Crump & Son, for Morton, Smart, C MacDonald & Milligan, W.S.]