

RAMSAY COMES TO HONG KONG

When I accepted appointment as one of the Non-Permanent Judges of the Court of Final Appeal I did so with pleasure as well as pride. Pride - because it is a great privilege and responsibility to serve in such a Court. And pleasure for two reasons. First, because it gives me an excuse to make regular visits to Hong Kong, a place for which Ann and I have always felt great affection. And secondly, because I hope it will enable me to give back something of value to the region in return for all the hospitality we have enjoyed here.

The first duty which Chief Justice Li laid upon me was to deliver tonight's talk. I must leave it to you to decide whether it qualifies as something of value. The Chief Justice told me that it could be on a subject of my choice. Fortunately he enclosed with his letter a copy of the judgment of the Court in *Shiu Wing Ltd v Commissioner of Estate Duty* (commonly known as Mr Pong's case). Rightly or wrongly I took this as an invitation to speak on that case and the principle, known as the Ramsay principle) which it involved. Speaking on this subject gives a pleasing symmetry to my career. I was Leading Counsel for the Inland Revenue in the two cases,

Ramsay v Inland Revenue¹ and Furniss v Dawson² in which the principle was established in England; and in that capacity I was often asked to speak about those cases. The last time I delivered a lecture on that subject was in 1986 only two or three days after taking up my first judicial appointment as a Judge of the High Court in England. So it is appropriate that, this evening, I should give another talk on the same subject only two or three days after taking up what must be my last judicial appointment anywhere.

I must preface my remarks with a warning. Any opinion which a judge expresses in an article or lecture, without the benefit of reasoned argument, is provisional only. When I give a lecture, I am often asked: "How do you reconcile what you have just said with what you said in your judgment in such and such a case?" And I reply: "I have changed my mind." I hope that what I say this evening about the Ramsay principle is helpful: but don't assume that I will say the same thing if the point comes before me in a judicial capacity, either here or in England.

Mr. Pong's case is of great importance, because it decided that the Ramsay principle is part of the law of Hong Kong. For those of you who are not familiar with the subject, the principle is part of our tax law. It is a potent

¹ [1982] AC 300

² [[1984] AC 474

weapon in the Revenue's armoury to defeat artificial tax avoidance schemes. It is a common law doctrine devised by the House of Lords without any statutory support. It combines a purposive construction of the Taxing Acts with a realistic approach to the facts. The Courts are no longer required to consider separately each step in a composite transaction intended to be carried through as a whole. They may have regard to the transaction as a whole, and may disregard steps which have no commercial purpose but are inserted purely to avoid tax.

The Court of Final Appeal was not obliged to import the principle into Hong Kong. Though now well established in England, it was highly controversial when it was introduced in 1982. The Court could have refused to apply it in Hong Kong. Even in countries which retain appeals to the Privy Council the courts are free to reject innovative decisions of the House of Lords which are felt to be inappropriate to their local circumstances. The common law is no longer regarded as monolithic. It adapts itself to the differing circumstances of the countries in which it has take root. In 1996 the Privy Council³ held that the New Zealand Court of Appeal was entitled not to follow the decision of the House of Lords in *Murphy v Brentwood District Council*⁴, on the

³ In *Invercargill City Council v Hamlin* [1996] AC 624.

⁴ [1991] 1 AC 398

ambit of the duty of care, and last year the Privy Council remitted a defamation case to the New Zealand Court of Appeal to consider whether the new test of qualified privilege laid down by the House of Lords in *Reynolds v Times Newspapers*⁵ should be applied in New Zealand. They decided to adopt a different test. The House of Lords has recently abolished the immunity of barristers for work in Court. Canada has never had such immunity. Australia has refused to abolish it. The issue is sensitive to the needs of the society in which the immunity is claimed. The Court of Final Appeal here will have to decide this issue for itself. It will not be obliged to follow the United Kingdom rather than Australia. The answer will depend on the Court's assessment of what Hong Kong's circumstances require.

While appeals still lay to the Privy Council, the Hong Kong Court of Appeal would almost certainly have loyally applied the *Ramsay* principle. After the hand-over in 1997, it was not a foregone conclusion that the Court of Final Appeal would apply it.

Nevertheless, I am sure that it was right to do do. The *Ramsay* principle was controversial but it was not novel, and it is not a peculiarly English principle. Indeed, it is drawn from the jurisprudence of the United States, and particularly the work of Learned Hand J in the New York Court

⁵ [1999] 3 WLR 1010

of Appeals, to my mind the greatest American judge never to have been appointed to the Supreme Court and a master of tax law. Moreover, it brought the United Kingdom closer to the mainstream tax law of other countries. What was peculiar to the United Kingdom before Ramsay was the old, literalist approach to the construction of the Taxing Acts and a blinkered approach to the facts which forced the courts to adopt a step by step analysis of closely integrated schemes, treating each step as a distinct transaction with its own tax consequences. In fact, as we shall see, the Ramsay principle is of general application. It is not confined to tax avoidance schemes.

Some of the schemes are very complex, and it is easy to get lost in the details. The way in which the principle works is best understood by looking at the simple cases. I should like to take two pairs of cases, each consisting of one case from England and one from the United States. The first pair of cases is concerned with identifying the parties to the relevant transaction. The first case is *Furniss v Dawson* itself, which was essentially a replay of the great case of *Helvering v Gregory*⁶ decided by Learned Hand J. in 1934. Both were tax cases concerned with essentially the same scheme to avoid capital gains tax on a sale of shares. Instead of selling their shares direct to the purchaser, the

⁶ (69 F.2d.809 (2d f.Cir.1934) aff'd. 293 U.S. 465 (1935)).

taxpayers split the transaction into two. First they formed a new company (Greenjacket in England) and sold the shares to the company in return for an issue of shares in the new company. This attracted a statutory exemption as a share exchange. Next they procured the company to sell the shares to the purchaser. This would not attract capital gains tax because the gain had been realised by the share exchange. In both cases the taxpayer lost. The two steps were planned together, and the Taxing Act had to be applied to the entire transaction, not separately to each step. Greenjacket was never intended to retain the shares. Its interposition between the taxpayers and the purchaser had no commercial purpose.

Now an almost identical approach has been adopted in England in a non-tax context. In England, farmers normally occupy their farms under yearly tenancies. Since 1948 statute has given them security of tenure. If the landlord serves a notice to quit the tenant can serve a counter-notice. If the tenant serves a counter-notice, the notice to quit has no effect unless an Agricultural Tribunal gives consent. Unfortunately the statute makes no provision for subtenants. If the farm is occupied by a subtenant, he can serve a counter-notice if his immediate landlord serves a notice to quit on him. But he has no right to serve a counter-notice on the superior landlord or to compel his immediate landlord to serve a counter-notice. If the superior landlord serves a notice to quit on the intermediate landlord, and the

intermediate landlord serves no counter-notice, the head tenancy will expire and this will automatically bring the subtenancy to an end. All this was recently confirmed by the House of Lords in a case⁷ earlier this year. In that case the tenancy and the subtenancy were independent transactions entered into at different times. In a case in 1988⁸, however, a landowner who wanted to let the land to a farmer without giving him security of tenure let it to his wife who immediately sublet it to the farmer. The wife was obviously never intended to occupy the land. Like the intermediate company in *Helvering v Gregory* and *Furniss v Dawson*, her tenancy had no commercial purpose. It was interposed between the landowner and the farmer in order to circumvent the Act and avoid giving the farmer security of tenure. If the owner wanted possession, he would serve a notice to quit on his wife, who obviously would not serve a counter-notice. But the arrangement was not a sham. It was intended to take effect according to its tenor. Civilian systems have a doctrine known as *abus de droit* - abuse of the law - which would have defeated the scheme. The common law has no such doctrine. Nevertheless the Court of Appeal held that the scheme did not work. For the purpose of the Act, the tenancy and the subtenancy had to be looked at together as a single

⁷ *Barrett v Morgan* [2000] 1 All ER 481.

⁸ *Gisborne v Burton* [1988] 3 All ER 760.

transaction. So regarded, the statute required notice to quit to be served on the subtenant by the freeholder, not by his wife.

The other pair of cases are concerned with the subject-matter of the transaction, which was the question in Mr. Pong's case. The first case is: *Commissioner of Internal Revenue v Ickelheimer*⁹ decided by Learned Hand J in 1943. Tax was chargeable on gifts of shares or other property where the donor and donee were within a specified relationship. Tax was not, however, chargeable on gifts of money. A wished to give some shares to B, who was within a specified category. He sold the shares to a third party and gave the proceeds of sale to B, who immediately bought the shares back from the third party. Learned Hand J held that the transaction was taxable as a gift of shares. In a judgment approved by the Supreme Court, he said:

"No doubt the most important single factor in ascertaining [the meaning of the statute] is the words it employs. But the colloquial words of a statute have not the fixed and artificial content of scientific symbols....Here we can have no doubt of the purpose at which Congress was aiming. We truncate if we do not include transactions by which, *in accordance with a pre-existing design*, property passes by whatever combination of moves from one member to another of the specified categories."

⁹ (1943) 132 F 2d 660.

A similar conclusion was recently reached by Langley J. in England¹⁰. A company wanted to pay bonuses to its directors. If they were paid in cash in the normal way the company would become liable to pay national insurance contributions. So it decided to pay the bonuses in platinum sponge. However, the directors did not want platinum sponge. They wanted money. So the company arranged to buy platinum sponge from a supplier; give the sponge to the directors by way of bonus; and for the supplier to buy the sponge back from the directors. The sponge itself remained throughout in the custody of a bank here in Hong Kong. None of the directors had any use for the sponge and would not sensibly have retained it. The Court held that National insurance was payable. Any other result would have been absurd.

As the passage I have cited from Learned Hand J's judgment in *Ickelheimer* shows, the Ramsay principle is a principle of statutory construction. It is a fundamental principle of the constitutions of the United Kingdom and the United States that the subject is to be taxed by the legislature, in the one case Parliament and in the other Congress, and not by the Courts. The same is true here in Hong Kong. In all three jurisdictions, therefore, every tax case, ie. every question of tax or no tax, is a question of

¹⁰ *NMB Holdings Ltd. v Secretary of State for Social Security* (Unreported) Times 10th. October 2000.

statutory construction. The question in every case is: whether what the taxpayer did was within the intendment of the particular statutory provisions relied on. In *Ickelheimer* Learned Hand J did not treat the gift of money from A to B as a gift of shares. He did not recharacterise the transaction. He merely said that the words of the statute should be construed as extending to such a transaction. In the case of the agricultural tenancy, the Court of Appeal did not say that the subtenant held directly from the freeholder. He did not. He held under a subtenancy granted by the freeholder's wife. The Court merely held that in the particular circumstances of the case the statute required the freeholder to serve a notice to quit on the subtenant.

In English cases since *Ramsay* the House of Lords has repeatedly emphasised that the principle is one of statutory construction¹¹. In *Mr. Pong's* case, Sir Anthony Mason described it as a principle of statutory construction and a realistic approach to the facts. The *Ramsay* principle does not permit the Court to recharacterise the facts. It requires the Court to apply the statute to what the taxpayer has actually done. It does not permit the Court to apply the statute to what he might have done to achieve his commercial object but did not do. But it allows the Court to take account of the fact that the individual steps in the transaction were not

intended to have independent existence but were merely steps in a pre-existing design.

This is why I do not like to describe the process as one of "re-characterisation". The Court has no jurisdiction to re-characterise the facts. It takes them as it finds them. Similarly, I do not like the suggestion that the principle allows the Court to "disregard" steps which are inserted for no other purpose than to avoid tax (or in a non-fiscal context circumvent the statute). This is sometimes taken to mean that the Court can ignore such steps or treat them as not having happened. But the Court has no jurisdiction to ignore the facts. What it does when it applies the **Ramsay** principle is to accept that the several individual steps took place, but take account of the fact that they were only steps in a larger transaction when applying the statute. In **Helvering v Gregory** Learned Hand J did not recharacterise the transaction as a sale by taxpayer to the purchaser. He did not disregard the interposition of the intermediate company. He took the transaction as it stood, applied the business purpose test (which showed that the interposition of the intermediate company had no commercial purpose), and ruled that the first step was outside the scope of the relevant exemption. He said:

"We cannot treat as inoperative the transfer of shares by A Co. or the issue of shares by B Co. of its own shares....B.Co had juristic personality....All these steps were real; their only defect was that they were not what the statute meant."

In the farming case the Court did not disregard the interposition of the wife's tenancy. It simply decided that, in the circumstances, it did not avoid the requirement that the subtenant should be served with notice to quit.

There have been a number of cases in England since *Furniss v Dawson* in which the *Ramsay* principle has been invoked, sometimes successfully and sometimes unsuccessfully. Some of them are controversial. Curiously, as an architect of the principle, I never applied it on the Bench. I can deal briefly with the major cases.

Ramsay itself and its sister case *Eilbeck v Rawlings*¹² involved circular transactions. In each case the taxpayer had already realised a capital gain and wished to shelter it by making a capital loss which could be set against it. Of course he did not want to make a real loss, so he entered into a circular and self-cancelling scheme designed to create an exempt gain and a corresponding allowable loss. The money movements were circular - but so were the supposed transactions to which they gave effect. In each case the loss was simply the mirror image of the gain. It was incapable of independent existence. Lord Wilberforce held that the loss (or gain), which arose at one stage of an indivisible process and which was intended to be cancelled out by a later stage was

¹² The two appeals were heard together. The detailed schemes were different. Neither worked even at the technical level.

"not such a loss (or gain) as the legislation is dealing with."

In other words, it fell outside the statute. The transactions were circular and self-cancelling and deliberately designed to produce neither gain nor loss in the real world. Lord Wilberforce's language is a distant echo of Learned Hand J's words in *Helvering v Gregory*.

I have already described *Furniss v Dawson*. It was not concerned with a circular transaction. It was concerned with a real or linear transaction with enduring consequences. But there is no doubt that the taxpayer disposed of his shares. The only question was whether he could avail himself of the statutory exemption for share exchanges. If the two stages must be analysed separately, he could. But they were part of a single, pre-ordained scheme, and it was held that he could not. This is often described as "looking at the end result." The end result was that the purchaser bought the shares for money. So it is tempting to "re-characterise" the transaction as a whole as a sale of the shares to the purchaser carried out in two stages instead of one. I think that Learned Hand J would turn in his grave at the idea. The taxpayer did not dispose of the shares to the purchaser. He disposed of them to the intermediate company. This was a real transaction. It cannot be simply disregarded. "Its only defect", to adopt Learned Hand's words, "is that it is not what the statute meant." In other words, it was not the kind

of share exchange which Parliament intended to have the benefit of the exemption.

Craven v White was one of three cases which were heard together. The taxpayer won in all three cases on the ground that there was no single composite transaction. The steps were genuinely independent. *Craven v White* itself was very near the line. It was the same scheme as in *Furniss v Dawson*. The only difference is that at the time the share exchange took place the taxpayer had not completed negotiations for the sale of the shares to the ultimate purchaser. I think the taxpayer was lucky. Indeed, the House was divided three to two. I believe the problem lies in the use of the word "pre-ordained". This was introduced by Lord Diplock in *Inland Revenue Commissioners v Burmah Oil*¹³ when he was seeking to explain the *Ramsay* principle. It is not the word which I had used when appearing for the Crown in *Ramsay* itself. I used the word "preconceived". I still think that it is the better term. But I think that Learned Hand J used an even better expression "in accordance with a pre-existing design".

¹³ (1981) 54 TC 200. This is the case in which Lord Diplock introduced the concept of "disregarding" steps which were interposed and which had no purpose apart from tax avoidance.

Ensign Tankers Ltd.v Stokes ¹⁴ was a blatant tax avoidance scheme. The taxpayers financed the production and exploitation of a film. Most films lose money for the producers, though they invariably make money for the distributors. So film studios like to reduce the risks by entering into partnerships with others to finance the production of the film while distributing it themselves. In this case the taxpayers agreed to finance 25% of budget. They were not willing to be liable for more than this, but they wanted to obtain 100% of the capital allowances which the expenditure would attract. So they did not enter into a partnership with the studio. Instead they bought the film rights outright and financed the whole of the production themselves. They put up 25% of the money out of their own pockets and borrowed the other 75% from the studio on non-recourse finance, ie. on terms that it was only repayable out of the film receipts. This meant that they only risked the 25% they actually put up. Any loss above this would fall on the lender. But the taxpayer would incur 100% of the expenditure which attracted capital allowances. Unfortunately, because the taxpayer borrowed the money from the studio, the money movements were circular.

When the case came before me at first instance, I found it impossible to apply the Ramsay principle, only to

¹⁴ [1989] 1 W.L.R. 1222

be reversed in the House of Lords. They held that the transaction was a joint venture with no element of loan with the result that the taxpayers only incurred 25% of the expenditure and so could only claim 25% of the allowances. This was recharacterisation with a vengeance. I think that it involved treating the documents as a sham. As actually structured, the arrangements did not permit the studio to bring in another partner, for it had sold the film rights to the taxpayers. As recharacterised by the House of Lords, the studio retained a 75% interest in a joint venture and could have brought in other partners. The House of Lords were impressed by the circular money movements and the non-recourse nature of the borrowings. I am not convinced.

When I was Counsel for the Inland Revenue, I used to advise them to put themselves in the place of the people who devised the scheme. Why did they think that the scheme worked. What was the trick? That is the point at which the scheme should be attacked. It should not be attacked at some point which is not essential to the scheme, or is only part of the tidying up after the tax has been avoided. Otherwise, the next taxpayer will simply alter the scheme to meet the attack. Now that was merely tactical advice, but I think it is also a sound approach for the Court. It should ask itself: What is the trick? How has the taxpayer got round the statute? In *Furniss v Dawson* the trick was to interpose a company between the vendor and purchaser and invoke the share

exchange exemption. The Court held that the exemption did not apply to that kind of share exchange.

In *Ensign Tankers* the trick was to buy the film rights and make the expenditure which attracted the allowances out of borrowed money which would only be repaid if the film made money. The circular money movements and the non-recourse nature of the borrowing were red-herrings. Neither was an essential part of the scheme. The money movements were circular, but only because the taxpayers borrowed from the studio. The underlying transactions were not. The non-recourse nature of the borrowing had a commercial purpose: it limited the taxpayers' liability. But it was not necessary to obtain the tax advantage. The point was that capital expenditure attracts capital allowances. The allowances are available whether the taxpayer uses his own money or borrowed money, and it makes no difference if the taxpayer later defaults on the loan. In fact, they are available even if the taxpayer uses money which he has received as a gift. All that matters is that he actually incurs the expenditure. It cannot make a difference that he limits his liability by using money borrowed on non-recourse terms. Much commercial borrowing is made on such terms.

This brings me to *Mr. Pong's* case. Mr. Pong was a wealthy businessman who owned the controlling interest in a Hong Kong company which operated a steel mill in Hong Kong and the land on which the steel mill was located. He wished to

protect his assets after 1997 by placing them abroad. He also wished to settle them on his children. These are both legitimate commercial purposes, for in this context "commercial" is used in contradistinction to tax avoidance. Mr. Pong would still have wanted to place his assets abroad and settle them on his children even if estate duty did not exist. But naturally he wished to avoid estate duty if he could.

As you know, estate duty in Hong Kong is charged not only on assets passing on death but also on assets given away less than three years before death. Mr. Pong was 85, and there was an obvious risk that he might die within the three years. So he decided to take advantage of the fact that under Section 10(b) of the Estate Duty Ordinance Estate Duty is not payable in respect of property situate outside Hong Kong.

The scheme was a complicated one, but I can be summarise it as follows:

A. The shares.

- (i) Mr. Pong sold the shares to a company which he had previously arranged to be incorporated in the Isle of Man as trustee of a number of unit trusts.
- (ii) Mr. Pong received the proceeds of sale in Macau and immediately lent them to

the trustees of a discretionary settlement which he had previously established in the Isle of Man for the benefit of his children.

(iii) The trustees used the money to buy units in the unit trusts held by the Manx company.

(iv) Mr. Pong released the debt due from the trustees.

B. The land.

(i) Mr. Pong sold the land to the Isle of Man company and received the proceeds in Macau.

(ii) Mr. Pong gave the proceeds of sale to the trustees who used them to buy units in the unit trusts held by the Manx company.

The Isle of Man company had no money, so it was necessary to arrange a series of circular payments which all took place in Macau. Mrs. Pong borrowed money from a bank and lent it to the Manx company, which used it to pay Mr. Pong, who lent or gave it to the trustees, who used it to pay the Isle of Man company for the units, which repaid Mrs. Pong, who repaid the bank. The Court of Final Appeal described the circular money

movements as highly artificial. Mr. Justice Rogers JA in the Court of Appeal and Mr. Justice Litton in the Court of Final Appeal PJ emphasised out that the bank lending was genuine. (It was pretty unusual - it was an unsecured loan of \$139 million to a private individual and it lasted at the most for a few seconds - for the bank would not debit or credit any of the payments until it had all the cheques in its hands). But as Sir Anthony Mason pointed out, the question is not whether the payments were genuine, but whether they had any non-fiscal purpose. If they were not genuine, you do not need **Ramsay**. He concluded that the circular money payments were undertaken solely to avoid estate duty by transforming what would have been a gift of property within the jurisdiction into a sale of the property and a gift of the proceeds of sale outside the jurisdiction. With respect, that is plainly right.

But that is not the end of the story. The Court proceeded to disregard the money movements and consider "the end result". The Revenue argued that it was simply a gift by Mr. Pong of Hong Kong assets to his children. But this was inaccurate, because it ignored the fact that the children did not take the property absolutely but as indirect beneficiaries in unit trusts invested in the Hong Kong properties. The Court refused to reconstitute the transaction as an outright unconditional gift to the children, or as a gift to the Isle of Man company on condition that it issued the unit trusts to the children's settlements.

My original reaction was to think that the decision must be wrong. It appears to mean that the **Ramsay** principle can be circumvented by any transaction which is sufficiently complicated. The taxpayer can simply insert steps which in themselves have a non-fiscal purpose (like the settlements and the unit trusts) and then defy the Court to recharacterise the transaction. But as I have said: there is no need to recharacterise the transaction. The question is: what was the subject-matter of the transaction? Was it the Hong Kong assets? Or the units? Or the money?

Let us consider the matter from the Revenue's point of view. Mr. Pong wanted to keep the land and shares in the family. He was not proposing to sell them to a stranger and settle the proceeds of sale by a separate and independent transaction. He was proposing to retain the Hong Kong assets as the underlying assets of unit trusts the units of which would be held in trust for his children.

If the land and shares had been outside the jurisdiction, there would have been no problem. There would have been no need to insert the sale and loan and the circular money movements. Mr. Pong could have achieved his objective in a number of different ways. He could have settled the assets on overseas discretionary trusts and arranged for the trustees to exchange the assets for units of the unit trusts. Or he could have adopted an even simpler method, as we shall see.

The problem was that Mr. Pong's assets were in Hong Kong and could not be moved abroad. How could he transform them into foreign assets and yet keep them in the family? The trick was to sell the assets to the Manx company. The sale converted the shares and land into a debt owed by an overseas debtor (and therefore located overseas). Mr. Pong then lent (or gave) the money to trustees for his children. The final step in the scheme was for Mr. Pong to release the debt owed by the trustees. This was clearly part of the original scheme, for Mr. Pong made a will in which he released the debt on the same day as the scheme was implemented, although he did not execute a release by deed until much later. Evidently the plan was to execute a release, but it was thought too dangerous to do so at once. The will was a precaution in case Mr. Pong died before he released the debt. It is this which makes it clear that Mr. Pong was being generous. The sale was merely a step in an overall scheme of donation. Its sole purpose was to avoid estate duty by transforming the subject-matter of the gift from physical assets to money.

Now the sale was genuine, but was it the kind of sale which alters the subject-matter of a gift for the purposes of estate duty? The consideration was paid in the course of the circular money movements. Mr. Pong lent it on as soon as he received it. Since the movements were circular, they can be analysed by starting the circle at any point. Mr.

Pong claimed that the purchase consideration which he received from the Isle of Man company financed the loan to the trustees. But it would be equally true to say that Mr. Pong's loan to the trustees (which enabled them to buy the units from the Isle of Man company) financed the company's purchase of the Hong Kong assets. The truth is that the company and Mr. Pong financed each other. There was no money, and no sale and purchase. Disregard the money movements, and you are left with a complex transaction of gift into settlement the underlying subject-matter of which consisted of Hong Kong assets.

It is not necessary to recharacterise the transaction as an indirect settlement. It is sufficient to disregard the money movements and treat every step as gratuitous. So, the Revenue would argue, the complexities are merely details which distract one's attention from the underlying simplicity of the scheme. The Revenue would take it in stages:

A sells land to B and gives the proceeds of sale back to B who uses the money to pay the purchase price. This is a gift by A to B. The subject-matter of the gift is the land, not the money.

Now introduce a third party X. A sells the land to X and gives the purchase price to B who buys the land from X who uses the money to pay the purchase price to A. Does this make a difference? Obviously not. This is still a gift by A to

B. The subject-matter the gift is still the land, not the money. These are the facts of *Ickelheimer* and *NMB Holdings*.

Now introduce trustees. A sells the land to X and settles the proceeds of sale on B by paying the money to trustees on trust for B. The trustees then use the money to buy the land from X who uses the money to pay the purchase price to A. Does this make a difference? Obviously not. It is still a gift by A way of settlement on B. The subject-matter of the settlement is still the land, not the money.

Finally, introduce some unit trusts. A sells the land to X as trustee of the unit trusts and settles the purchase price as before. The trustees then use the money to subscribe for the units by paying it to X who uses it to pay the purchase price to A. This is Mr. Pong's case. Does the introduction of the unit trusts make all the difference? The transaction is still gratuitous. Whatever may be the subject-matter of the individual steps, the subject-matter of the transaction taken as an integrated whole is still the land. The reality, in all these cases, is that the sale which transformed the subject-matter of the gift was only a step in an integrated transaction designed to pass the land into the indirect beneficial ownership of B.

That is how the Revenue would argue the case. And I originally thought that it was unanswerable. But I have changed my mind. The key is in that word "indirect". The Hong Kong assets did not remain throughout in the beneficial

ownership of the family. They passed into the beneficial ownership of the Isle of Man company. Does that make a difference? The answer is not obvious.

The fact is that Mr. Pong could have adopted a much simpler and more straightforward means to achieve his objectives. He could simply have transferred the Hong Kong assets to the Isle of Man company as trustee of the unit trusts in exchange for units and then settled the units on discretionary trusts for the benefit of his children. No smoke, no mirrors, no circular money movements, no artificial steps to be disregarded. Just a two-step transaction. Would it have avoided estate duty? If so, then so should Mr. Pong's actual scheme. And if not, not. Another donor might adopt an even simpler scheme. He might simply transfer the Hong Kong assets to an offshore company in exchange for shares in the company, and then give the shares to his children.

In the long run the Courts here cannot avoid the question whether such simple transactions avoid estate duty or not. What is the subject-matter of the gift? Is it the Hong Kong assets? Or is it the units or the shares in the overseas company? These are certainly the subject-matter of the gift, ie. the second step. But the **Ramsay** principle allows the Court, for tax purposes, to have regard to the two steps together if they were planned together. And the subject-matter of the transaction taken as a whole is the Hong Kong assets.

At first sight the scheme appears to be only a variant on *Furniss v Dawson*. But I have come to the conclusion that it is not. In that case the result of the scheme was that the purchase price ended up in the intermediate company Greenjacket. This was not what the taxpayers wanted. It was the price they were prepared to pay for the avoidance of tax. But they would have preferred to have the money in their own pockets. In the present case the transfer of the Hong Kong assets to the Isle of Man company was not merely the price Mr. Pong had to pay in order to avoid estate duty. It had the independent commercial purpose of safeguarding his assets by transferring control overseas. This was something which he would have wanted even if he was not intending to give the assets to his children. There is no question of disregarding either of the two steps for the purpose of the Ordinance, for neither of them was taken for wholly fiscal reasons. The first step safeguarded the assets by placing them in foreign ownership. The second step was a gift. Although planned together, I think that for the purpose of the Ordinance the subject-matter of the gift was the units, not the land.

This approach is highly fact-sensitive. It does not depend on the details of the scheme. Paradoxically, the smoke and mirrors were unnecessary. But the success of the scheme does depend on the presence of a non-fiscal reason, unconnected with the intention of making the gift, for transferring control of the assets abroad. It also depends on

the assets remaining abroad. Perhaps this is as it should be. The legislature may think that Section 10(b) of the Ordinance makes estate duty avoidance altogether too easy. If so, it may wish to reconsider the Section in the light of the three year rule. It is one thing to exempt property which neither is nor represents property which was located in Hong Kong within three years before the death. It is quite another to exempt such property as well. The Revenue did not deny that Section 10(b) has the wider effect. The Ramsay principle depends on a purposive construction of the relevant legislation. It cannot be used to subvert it. It is a potent weapon in the hands of the Revenue where the legislation is adequate, but it cannot do the job alone.