[2012] UKPC 9
Privy Council Appeal No 0028 of 2011

JUDGMENT

Commissioner of Taxpayer Audit and Assessment (Appellant) *v* Cigarette Company of Jamaica Limited (in Voluntary Liquidation) (Respondent)

From the Court of Appeal of Jamaica

before

Lord Walker
Lord Mance
Lord Wilson
Lord Sumption
Sir Patrick Coghlin

JUDGMENT DELIVERED BY LORD WALKER ON

13 March 2012

Heard on 15 February 2012

Appellant	*Respondent*
Christopher McCall QC	David Milne QC
Lackston Robinson	Vincent Nelson QC
(Instructed by Charles Russell LLP)	(Instructed by Myers, Fletcher & Gordon)

LORD WALKER

Introduction

1. This is an appeal by the Commissioner of Taxpayer Audit and Assessment against an order of the Court of Appeal made on 12 February 2010. The Court of Appeal allowed the appeal of Cigarette Company of Jamaica Ltd (in voluntary liquidation) ("CCJ") from an order of Anderson J made in the Revenue Court on 31 October 2007. Anderson J had dismissed CCJ's appeal against assessments to income tax for the years 1997 to 2002, except that the issue of penalties was remitted to the Commissioner for further consideration (with a recommendation that the penalty should be nil, or nominal).

2. The assessments (totalling about $2.17bn without any penalty) were in respect of large sums (totalling about $6.4bn between 1997 and 2002) paid by CCJ to Carreras Group Ltd ("Carreras") during that period. CCJ was a subsidiary of Carreras, but not a wholly-owned subsidiary. Its shareholding increased from about 90% (at the beginning of the period) to about 99.7% (at the end). These payments were consistently shown as loans in both companies' audited financial statements. But the Commissioner contended that they should for the purposes of the Income Tax Act be treated as distributions subject to income tax deductible at source under section 38 of that Act.

3. This contention relied in the first place on the wide definition of distribution in section 34 of the Act, and in the second place on section 16 of the Act, which makes special provision in relation to artificial or fictitious transactions directed at the reduction of tax liability.

The facts

4. Before coming to the detail of the statutory provisions it is desirable to set out the primary facts rather more fully than in the judgments below. Before the Board the fact that Carreras did not at any time during the relevant years of assessment have a full 100% shareholding in CCJ (though it had come very close to it, by the end of the period) has assumed more importance than it did below. In addition an agreement dated 1 September 1977 ("the 1977 agreement") may not have been seen in its full commercial context.

5. The general effect of the 1977 agreement was to merge two cigarette manufacturing businesses. It was partly a sale agreement and partly a shareholders' agreement as to how the merged businesses would be run. Before the agreement was made one business belonged to two companies, which were wholly-owned by Carreras. Rothmans International Ltd ("Rothmans"), an English company, owned about 48% of the shares in Carreras. The purchasing company was CCJ, then named B & J B Machado Tobacco Co Ltd. British American Tobacco Ltd ("BAT"), another English company, owned about 86% of CCJ's ordinary shares and about 81% of its preference shares. All these companies were parties to the 1977 agreement.

6. At the time of the agreement CCJ had in issue 2,000,000 ordinary shares of $1 each and 5,900 8% cumulative preference shares of $40 each. So BAT had about 1,720,000 ordinary shares, with about 280,000 in other hands. Under the agreement the vendor companies sold their business assets to CCJ for $5.8m, to be satisfied by the issue to the vendor companies, or as they should direct, of 5,800,000 new ordinary shares in CCJ, credited as fully paid. In addition BAT was to sell to the vendor companies, or as they should direct, at a nominal consideration, 1,220,000 ordinary shares in CCJ. The requisite directions were given in favour of Carreras. The result was that on completion CCJ had an issued ordinary share capital of 7,800,000 $1 shares held as follows:

7,020,000 (90.0% approx) Carreras;

500,000 (6.4% approx) BAT;

280,000 (3.6% approx) other shareholders.

The preference shares (with a nominal value of $236,000) are of little importance as the 8% nominal yield was well below the rate of inflation in Jamaica throughout the period. It appears that Carreras owned them all by 1979 [Record p1012].

7. The 1977 agreement contained provision for management fees (clause 9), trademarks and allied rights (clauses 10, 12, 16 and 17) and a lease of business premises (clause 11). That was the context of clause 13(c)(i) which was in the following terms:

> "That [Carreras] may at its sole discretion (but with the approval of [CCJ]) borrow from [CCJ] such amounts as it may from time to time require free of interest, provided however that [Carreras] guarantees to [CCJ] the repayment of such borrowings at such times and in such manner as [Carreras and CCJ] may mutually determine, and provided

> also that [Carreras] shall not borrow any amounts under this clause until Barclay's Bank of Jamaica Ltd has released BAT from the guarantee referred to in clause 19."

That was part of a clause which was expressed, no doubt advisedly, as a mutual covenant between Carreras (the majority shareholder) and BAT (the largest minority shareholder). It did not and could not bind the other, smaller minority shareholders, who were not parties to the 1977 agreement.

8. Carreras was referred to in some of the documentary evidence as a conglomerate. Apart from CCJ it had other wholly-owned subsidiaries engaged in a variety of activities: agriculture (especially tobacco-growing), the printing trade, the hotel trade, and the manufacture of biscuits. From 1997 until the end of the 1980s the picture emerging from the financial statements of Carreras and CCJ is that Carreras was actively carrying out treasury functions, so that it was sometimes a creditor, and sometimes a debtor, of its subsidiaries. There were also loans between subsidiaries themselves. So for example CCJ's balance sheet as at 31 March 1984 [Record p1102] shows current assets including about $7.7m due from fellow subsidiaries, and about $0.6m due to Carreras. The unchallenged evidence of Mr Ashenheim (the Chairman of Carreras and a member of the Board of CCJ) was that despite the terms of the 1977 agreement Carreras never charged CCJ any royalties for use of its trademarks. There seems to have been quite a large element of, to put it colloquially, swings and roundabouts, in the management of the group. There seems to be no reason to suppose that at that period the small minority shareholders of CCJ would have had any reason to complain of oppression conducted by the majority, and there is no sign that they did complain.

9. It is clear from the documentary evidence (which includes several annual reports to shareholders by the Chairman of Carreras, and minutes of its annual general meetings) that Carreras's various subsidiaries were not all equally prosperous. Jamaica's economy was in a bad way and there was severe inflation. The agricultural and hotel subsidiaries had many problems. The business of CCJ, on the other hand, became very profitable. Its profits increased rapidly in every year from 1990 to 2001, from about $42m in 1990 to about $1,334m in 2001 (though some of the increase must have been the effect of high inflation throughout this period).

10. During 1998 Carreras's holding of ordinary shares in CCJ increased to about 99.7 % [Record p1507]. It appears from the Chairman's report to the annual general meeting in 1998 [Record p 1948] that this included the whole of BAT's holding. BAT's divestment of its holding in CCJ was however only a prelude to a larger investment at a higher level. On 1 June 1999 there was an announcement of an international merger between BAT and Rothmans, and BAT became the holder of 50.4% of the ordinary shares in Carreras [Record p1779].

11. The outstanding 0.3% of the ordinary shares appears to have been held by a number of small shareholders. The documentary evidence contains resolutions of the CCJ Board of Directors approving transfers to Carreras in 1995, 1998 and 2003 [Record pp1723, 1729 and 2018-2025]. The 1998 resolution included a transfer by BAT to Carreras of 3,603,081 ordinary shares in CCJ. CCJ was issuing bonus shares on an almost annual basis and it is difficult to keep track of the numbers. One of the largest of the small minority holdings, transferred in 2003, was 14,940 shares held by the Kingston Port Workers Superannuation Fund.

12. It is clear from the audited financial statements that by the 1990s there was no longer much "swings and roundabouts" in the operation of Carreras's treasury function, at least as far as CCJ was concerned. CCJ's large after-tax profits were used to pay a relatively very low dividend ($993,000 in 1990, rising gradually to $3.7m in 2001), the balance of profit was retained, and sums roughly equivalent to the retained profits were loaned, interest-free and unsecured, to Carreras. From 1991 the bulk of Carreras's indebtedness to CCJ was shown in CCJ's balance sheet, not as a current asset but as a separate item [Record p1277]. The corresponding item in Carreras's balance sheet had a note referring to amounts "for which no repayment terms have been fixed" [Record p1296].

13. Mr McCall QC, for the Commissioner, submitted that in making very large unsecured interest-free loans to Carreras, and leaving them outstanding from year to year during a period of high inflation, CCJ had improperly subordinated its interest to that of Carreras, to the detriment of its own shareholders (especially the minority shareholders). Mr Milne QC, for CCJ, referred to the well-known and well-established practice of one company in a group performing a treasury function, and treating a group of companies as a single economic unit. Mr McCall did not refer to authority but he might have referred to *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324, a remarkable case in which a co-operative society formed a partly-owned subsidiary, and after a few years set about trying to destroy it. The present case is on any view a long way from that, but there is no evidence or finding that in adopting and continuing this policy the board of CCJ was giving separate consideration to the interests of its shareholders (and especially its minority shareholders): for the need for separate consideration see *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch 62, 67. More recent cases applying these principles are *Nicholas v Soundcraft Electronics Ltd* [1993] BCLC 360 and *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598.

14. The position is summarised as follows in *Mortimore, Company Directors* (2009) para 12.18:

> "In practice, however, it may be possible for the directors of a subsidiary to take into account the interests of the group more than the

> *Charterbridge* case suggests. Certainly, if the intended measure is likely to promote the success of the company for the benefit of its members as a whole, it is not a breach of duty for the director to take into account the benefit to the group as a whole. Moreover, in the case of a solvent company the interests of the subsidiary are likely to include the interests of its shareholders generally. In the case of a wholly-owned subsidiary, the interests of the subsidiary will therefore include its holding company."

As this passage indicates, in practice problems are most likely to arise if the subsidiary is at risk of insolvency, or is only a partly-owned subsidiary. In those cases the directors of the subsidiary will be under a duty to consider the interests of creditors or of minority shareholders.

15. Anderson J observed [Record p492] that Carreras "as a 99.8% shareholder had virtually unlimited power to commandeer the surplus cash held by [CCJ]". He seems to have supposed that Carreras had a 99.8% holding throughout the relevant period. In the Court of Appeal Morrison JA (who gave the leading judgment) reached much the same conclusion but expressed it in much less opprobrious terms (paras 90-91):

> "The evidence established, without contradiction, that the group structure, whereby [Carreras] as the parent company provided management and other support services, such as a centralised treasury function, for its subsidiaries, including CCJ, had been in place for over 30 years. As Lord Hoffmann NPG observed in [*Commissioner of Inland Revenue v HIT Finance Ltd (FACV Nos 8 and 16 of 2007)*] there is 'nothing odd' about this. In my view, this longstanding relationship between [Carreras], the parent, and CCJ, its virtually wholly-owned subsidiary, renders of far less significance than would ordinarily be the case the absence of documentary evidence of the terms of the loans, an agreed repayment schedule or the agreement that the extending of the loans free of interest would be in exchange for the use by CCJ of [Carrerras's] trademarks without payment of royalties.
>
> The reality was that the Group Finance Director, as Mrs Sutherland's evidence indicated, was responsible for the accounting function of [Carreras] as well as overseeing that of the subsidiaries. As a result of this functional connection between the companies, the annual budgeting process of [Carreras] and the subsidiaries was centrally coordinated, with the further result that by the time the process was completed, the management of each subsidiary and of [Carreras], to quote Mrs Sutherland, 'had effectively approved the projected inter-company movements for the ensuing financial year.'"

Morrison JA may also have overlooked the changes, during the period, in the size of Carreras's holding in CCJ.

16. This is a tax appeal, not an appeal about oppression of minority shareholders. It may be – but it is not for the Board to express any view – that in the 1990s the directors of CCJ did lose sight of the interests of the very small body of minority shareholders. The issue for the Board is whether the loans (and it is now common ground that they were loans) that CCJ made to Carreras between 1997 and 2002 were artificial transactions within section 16 of the Income Tax Act, and if so how sections 16 and 34 of the Act apply to them.

17. To complete the factual narrative, in 2003 the decision was taken to carry out a major reorganisation of the group. The policy of a conglomerate group was abandoned and most of the non-tobacco businesses were disposed of or closed. Carreras was to become the operating company of the tobacco business and CCJ was to be put into liquidation. BAT intended to make an offer to acquire some (but not all) of the 49.6% of Carreras's shares that were traded on the Jamaica Stock Exchange. These facts appear from a letter that KPMG wrote on 18 February 2003 to the Director General of the Ministry of Finance seeking various tax clearances, the details of which are not material. During the course of this application the Commissioner raised the issues that are now before the Board. Notices of estimated assessment were issued on 1 April 2003, and correspondence ensued. On 1 January 2004 Carreras began the process of putting subsidiaries into liquidation and on 27 February 2004 Carreras paid to CCJ the whole of the indebtedness, amounting to about $10.58bn. Mr Rolf Lanigan was appointed as liquidator of CCJ on 15 March 2004.

The statutory provisions

18. Section 16(1) of the Income Tax Act is as follows:

> "Where the Commissioner is of opinion that any transaction which reduces or would reduce the amount of tax payable by any person is artificial or fictitious, or that full effect has not in fact been given to any disposition, the Commissioner may disregard any such transaction or disposition, and the persons concerned shall be assessable accordingly."

19. Section 34(1), so far as now relevant, is as follows:

> "34. (1) Any act by a body corporate subject to income tax which falls within any paragraph of the following Table but not within any exception to that paragraph shall be treated for the purposes of this Act

as a distribution by the body corporate, but, . . . no other act shall be so treated.

Table of Company Distributions

. . .

Distributions to shareholders

1. Any dividend.

. . .

2. Any payment, other than a dividend, made (whether in cash, goods or otherwise) in respect of shares in the body corporate out of assets of the body corporate or so that the cost of it falls on the body corporate, excluding such payments made in the winding-up of a body corporate.

Exceptions: (a) so much of any payment as represents a repayment of capital on the shares (including repayment of any premium at which the shares were issued);

(b) so much of any payment as is proved by the body corporate to have been made out of capital assets.

. . .

9. The grant of a loan falling within section 35."

20. Section 35 is as follows:

"35 (1) A body corporate subject to income tax shall be treated as making a distribution where it grants a loan, otherwise than in the course of a bona fide business of lending money –

(a) to a principal member of the body corporate or of any other body corporate connected with it; or

(b) to a relative of any such principal member; or

(c) to any other person on terms such that any such principal member or relative indirectly receives the equivalent of the loan or part of it:

Provided that this subsection shall not apply –

(i) if the principal member is a body corporate resident in the Island; or

(ii) if the principal member is a body corporate resident out of the Island and the Minister has approved the loan as being beneficial to the economy of Jamaica; or

(iii) if the loan is granted by a company to a person employed by it where loans on the like terms are made available by the company to all its staff in similar employment."

21. It is common ground between counsel that in section 16(1) "artificial" has a meaning different from, and wider than, "fictitious" (the latter expression approximating in meaning to "sham"). Counsel accepted that authoritative guidance has been given (in relation to an earlier provision in the same terms as section 16) by Lord Diplock in *Seramco Ltd Superannuation Fund Trustees v Income Tax Commissioner* [1977] AC 287, 298:

" 'Artificial' is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. In common with all three members of the Court of Appeal their Lordships reject the trustees' first contention that its use by the draftsmen of the subsection is pleonastic, that is, a mere synonym for 'fictitious'. A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. 'Artificial' as descriptive of a

> transaction is, in their Lordships' view a word of wider import. Where in a provision of a statute an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case. Their Lordships will accordingly limit themselves to an examination of the shares agreement and the circumstances in which it was made and carried out, in order to see whether that particular transaction is properly described as 'artificial' within the ordinary meaning of that word."

22. As Lord Diplock indicates, context is very important. In relation to a natural, tangible object (such as silk, or leather, or even a human limb) it is not a matter of degree: either an object is artificial, or it is not. But a transaction is an abstract construct. Every transaction is in a sense artificial in that it is put together by two or more parties in order to create or alter legal rights and obligations as between them. While mindful of Lord Diplock's warning against too much judicial exegesis the Board consider that in this context a transaction is "artificial" if it has, as compared with normal transactions of an ostensibly similar type, features that are abnormal and appear to be part of a plan. They are the sort of features of which a well-informed bystander might say, "This simply would not happen in the real world." Recognising a transaction as artificial in this sense is an evaluative exercise calling for legal experience and judgment. It is certainly not an ordinary question of primary fact, as Mr McCall acknowledged in abandoning one of the main points in his written case.

23. A transaction is not artificial merely because it is not commercial, or not fully commercial. Income tax affects transactions by way of bounty as well as commercial transactions. But if a transaction effected in a commercial context is attacked as uncommercial that may be a reason for looking at it closely. To repeat what Lord Diplock said in the passage quoted above, it is necessary to examine the particular transaction and the circumstances in which it was made and carried out.

Were the loans "artificial"?

24. At the end of his long judgment, Anderson J concluded [Record pp526-527] that the loans were not genuine loans within section 35 of the Income Tax Act, and that they were distributions within section 34. If necessary he would have held that the transactions were artificial. Mr McCall does not seek to support his first ground of decision, but does support the alternative ground based on section 16.

25. The judge's reasons for his conclusions were set out in ten numbered paragraphs. It is not necessary to set them out in full. The essential points can be stated quite shortly.

(1) The judge was influenced by the absence (as he saw it) of documentary evidence of management policy, decisions, and implementation of decisions.

(2) No interest was paid on the loans, and there was no reliable evidence that this was a quid pro quid for use of Carreras's trademarks, or that these reciprocal benefits were quantified.

(3) No actual repayment of the loans was made until the decision in 2003 that there should be a major reorganisation.

(4) There was no evidence that external group borrowing was reduced as a result of the loans.

(5) "[Carreras], as a 99.8% shareholder had virtually unlimited power as a matter of fact and law, to determine what was to be done with surplus cash held by [CCJ]. There is no evidence that any explanation was every given to [CCJ] as to how [Carreras] proposed to use the funds in question."

26. The Board's views on these points can be shortly stated.

(1) Experience in company law cases suggests that board minutes often reflect immediate preoccupations rather than long-term policy, and are sometimes uninformative. An example is in the minutes of the Carreras board meeting on 6 February 1997 [Record p1825] which may be the only documentary reference to consideration of the minority shareholders. Under the heading "Any Other Business: minority interests in Cigarette Company of Jamaica" it reads, not very helpfully, "All correspondence submitted to the Board was taken as read. Management is awaiting a response as is evident from the correspondence dated January 10, 1997". In fact the financial statements and other documentary evidence in the Record contain a good deal of information, some of which is summarised above. But it seems that counsel did not take the judge to much of it in the course of the hearing.

(2) It may well have been a mistake for CCJ's advisers to rely on the trademarks point. There may have been a "swings and roundabouts" attitude at first, but the sums loaned during the 1990s were out of all proportion to any

plausible bargain. The only possible justification for the loans was the group structure.

(3) It is now accepted that the loans were real loans, which were as a matter of law repayable on demand (even if the auditors considered that a true and fair view was to classify them as non-current). Their existence was acknowledged regularly by directors of Carreras signing the balance sheet. Carreras was at all times in a position to repay the whole of the loans out of cash or readily realisable investments.

(4) The judge misunderstood the arrangement with Bank of Nova Scotia, which provided various banking facilities, including a standby loan facility which was not in fact used. Morrison JA drew attention to this point in para 94 of his judgment in the Court of Appeal. Carreras itself had massive reserves of cash ($146m in 1990 rising to $2.262bn in 2001) [Record pp1267, 1569] and relatively negligible external borrowing.

(5) The group structure was not, as the judge seems to have been suggesting, a reason for treating the loans as artificial. It was, on the contrary, the commercial context in which there was nothing abnormal or artificial in the loans being unsecured, interest-free, and documented only by normal accounting and auditing processes. Had the CCJ been a wholly-owned subsidiary of Carreras throughout the relevant period the conclusion that the loans were not artificial would have been clear and irresistible. It would have been a paradigm case of a loan which, although not on commercial terms if looked at in isolation, falls squarely within proviso (i) to section 35(1) of the Income Tax Act. Any element of bounty in the transaction would have remained within the reach of Jamaican corporate taxation.

27. In fact, as already explained, there is some reason to suppose that during the 1990s the Board of CCJ paid insufficient attention to the interests of a small and diminishing number of minority shareholders. But in the Board's opinion that cannot make artificial what would otherwise have been standard practice in corporate group structures throughout the world. There was no artifice in this apparent error. On such evidence as there is it seems to have been an oversight, and not part of a plan.

28. The Board is therefore very largely in agreement with the clear and comprehensive judgment of Morrison JA, with which Panton P and McIntosh JA (Ag) agreed. Morrison JA did not go into the details of the changes in the minority shareholdings, but ultimately nothing turns on that. The Board does however respectfully differ from Morrison JA on two points, neither of which is determinative. First, para 75(viii) of the judgment may rather overstate the deference which an

appellate tribunal should accord to the Revenue Court on an issue which is not one of primary fact, but of evaluative judgment, especially in the context of artificial tax avoidance. As Lord Radcliffe put it in *Edwards v Bairstow* [1956] AC 14, 38-39 (mentioned later in Morrison JA's judgment):

> "But there is no reason to make a mystery about the subjects that commissioners deal with or to invite the courts to impose any exceptional restraints upon themselves because they are dealing with cases that arise out of facts found by commissioners. Their duty is no more than to examine those facts with a decent respect for the tribunal appealed from and if they think that the only reasonable conclusion on the facts found is inconsistent with the determination come to, to say so without more ado."

Second, the Board does not agree with Morrison JA's view, at para 99, that an artificial transaction would invariably (or even usually) involve dishonesty. In general it would do so only if it involved active deception, or non-disclosure which was in the circumstances tantamount to active deception.

29. The appeal should therefore be dismissed on the single ground that section 16 of the Income Tax Act has no application at all. It is not necessary for the Board to consider the other issues that would arise if the appeal had not failed at the first hurdle. The Board heard some argument on these other issues, but not full argument. They are issues of some importance and difficulty and it is better to leave them for another day.

30. The Board will therefore humbly advise Her Majesty that the Commissioner's appeal should be dismissed with costs before the Board.