Neutral Citation Number: [2012] EWHC 2032 (Fam)

Case No: FD11D05145

IN THE HIGH COURT OF JUSTICE
FAMILY DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 19/07/2012

Before :

MR JUSTICE MOSTYN

- -

Between :

	AC	**Applicant**
	- and -	
	(1) DC **(2) D Foundation** **(3) A Investments Ltd** **(4) B Investments Ltd** **(5) C Investments Ltd** **(6) D Investments Ltd** **(7) E Investments Ltd** **(8) F Investments Ltd** **(9) Z Trust Company Limited**	**Respondents**

- -

Ms Deborah Bangay QC, Mr David Ewart QC, Mr Dakis Hagen and Mr James Rivett
(instructed by **Levison Meltzer Pigott Solicitors**) for the **Applicant**
Mr Valentine Le Grice QC and Mr Giles Goodfellow QC
(instructed by **Brachers Solicitors**) for the **1st Respondent**
Mr Nicholas Carden (instructed by **Brachers Solicitors**) for the **2nd Respondent**
Mr Nigel Dyer QC and Mr William Massey QC
(instructed by **Brachers Solicitors**) for the **3rd – 7th Respondents**

Hearing date: 2 July 2012

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Judgment

MR JUSTICE MOSTYN

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

I permit reporting of this judgment in this anonymised form as

AC v DC and others (Financial Remedy: Effect of s37 Avoidance Order)

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Mr Justice Mostyn :

1. On 2 July 2012, at the suit of the Applicant ("W"), I set aside a transaction made by the First Respondent ("H") on about 2 December 2010, pursuant to s37(2) Matrimonial Causes Act 1973 ("MCA 1973"). That transaction was the transfer by H of his 86.24% shareholding in D (Holdings) Ltd ("DH"), a valuable enterprise, to the Ninth Respondent ("R9"), which is a corporate trustee in the Isle of Man. I further set aside under s37(3) MCA 1973 onward transmission by R9 of those shares to the Second Respondent ("R2") (as further described by me in paragraph 8 below) and the further onward transmission by R2 to the Third to Eighth Respondents (which are Manx Companies) and certain other related transactions. Each Manx Company is owned by a separate sub-fund of an Employer-Financed Retirement Benefit Scheme which had been established for H together with certain other directors and some minor shareholders of DH connected with the company's directors ("the directors").

2. The application was not opposed by any of the Respondents. Sadly H is very unwell and his life expectancy is limited. Were he to have died before the decision to set aside the transactions there would have been many adverse legal and fiscal consequences. Beyond explaining, in short form, why I was satisfied that the relevant criteria within s37 were met I did not give full reasons. I did not do so as all parties wished my judgment to incorporate my views as to whether the effect of a "set aside" is to operate retrospectively for all legal (including fiscal) purposes. I directed that further written arguments be supplied and I have received very full, detailed, and interesting submissions from all parties.

3. This is my judgment incorporating those views. I have not had submissions from HMRC. There was some discussion as to whether HMRC should be invited to intervene, or even joined as a party under FPR 2010 rule 9.26B. But the combined view was that this would engender a deal of delay, and given H's precarious state of health, no appreciable period of delay could be countenanced. So I have not heard any counter-arguments by HMRC to the unanimous view expressed to me by all parties (although it should fairly be stated that Mr Carden for the Second Respondent is more neutral than the others). Therefore my views will not bind HMRC, but they will surely, given the depth of learning which I have received, be influential. The same situation arose in *G v G (Financial Provision: Equal Division)* [2002] 2 FLR 1143, FD where Coleridge J gave an opinion at para 43 on whether the transfer to the wife of some shares in the husband's business would give rise to business hold-over relief so that the wife would receive the shares at the

husband's base value and that no liability to CGT would therefore arise on the husband as a result of the transfer. He opined that the relief would be available, but was careful to explain that he could not "ultimately bind the Inland Revenue". In *Hill v Haines* [2008] 1 FLR 1192, CA Rix LJ observed at para 81 that "the view expressed by Coleridge J [in *G v G (Financial Provision: Equal Division)*] at para [43] regarding potential consequences for the purposes of capital gains tax can hardly be regarded as authoritative in the absence of the Revenue". It may not have been authoritative, but it was influential as following publication of the judgment of Coleridge J the Inland Revenue adjusted its Practice Manual to reflect the terms of his opinion.

Background

4. I shall try to set out the relevant background as shortly as I can.

5. H and W married in 1998. H is now aged 62; W is aged 34. They have three children aged 14, 12 and 3. In 2008 W observed deterioration in H's behaviour in that he became increasingly aggressive and dis-inhibited. In June 2010 the marriage broke down in sad circumstances which do not need to be repeated here. In September 2010 a consultant neurologist diagnosed H as suffering from frontal lobe dementia. In December 2010 W issued divorce proceedings and a Form A. H was much distressed by this and persuaded W to agree to their dismissal. This was effected by a consent order made on 7 April 2011. W issued a fresh petition for divorce and Form A in October 2011. The medical opinion is that H is incapacitated under the terms of the Mental Capacity Act 2005. He is represented by his litigation friend Mr T. Decree Nisi was pronounced on 30 March 2012. On 2 July 2012 it was agreed that this Decree Nisi of divorce would be rescinded and that the petition would be amended to pray for judicial separation. I made orders abridging all time and dispensing with all formalities and heard W's evidence in proof of the amended petition; and pronounced a decree of judicial separation on 3 July 2012.

6. D Ltd was incorporated on 15 May 1997 and DH, the holding company, on 4 June 2003. It is a highly successful producer and distributor of certain products. Turnover in 2010 was £53m with a profit of £3.65m. It has been valued in the business press at between £75m and £100m. As stated above, prior to the transaction in December 2010 H held 86.24% of the shares.

7. As outlined above, on or around 2 December 2010 H transferred his shares in DH to R9 in its capacity as the sole trustee of the D (Holdings) Limited Employee Benefit Trust ("the Trust"). On or about 7 December 2010 R9 appointed all the shares which had been transferred to it by H upon the trusts of a sub-fund for the benefit of H, his wife for the time being and other members of his family. On 8 December 2010 R9 retired as trustee and appointed R2 in its place. On or about 13 December 2010 R2 entered into a sale and purchase agreement by which the shares were acquired by the Third to Eighth

Respondents, the Manx Companies described above.

8. There is a substantial query recognised by all represented parties' counsel as to the validity of the appointment of R2 in place of R9.

9. H's and his family's rights under the Trust are, technically, extremely limited. H, W and his children currently have no fixed right to the capital of the Trust, even under the sub-fund. On any decree absolute of divorce W would cease to be a beneficiary altogether, and would be limited thereafter in her right to make any applications in the administration of the Trust in the Manx courts or elsewhere.

10. On any view W's claims for a financial remedy were seriously compromised by these steps. Her anxiety has been heightened by the news that negotiations are advanced to sell DH for £62m. She sought and obtained injunctive relief and launched the s37 application which is before me.

Decision on the s37 application

11. In *Kremen v Agrest and Fishman* [2011] 2 FLR 478 I sought to summarise the principles that had to be met on an application for an avoidance of disposition order under the (identically) corresponding provisions of Part III of the Matrimonial and Family Proceedings Act 1984. I stated:

> *"Section 23 of the Matrimonial and Family Proceedings Act 1984*
>
> **[8]** This is the Part III counterpart to the more familiar s 37 of the MCA 1973. It is entitled '*Avoidance of transactions intended to defeat applications for financial relief*'.
>
> **[9]** For W's application to succeed the following has to be demonstrated:
>
> (i) That the execution of the charge was done by H with the intention of defeating her claim for financial relief. This is presumed against H, and he has to show that he did not bear that intention. See s 23(2)(a) and s 23(7). The motive does not have to be the dominant motive in the transaction; if it is a subsidiary (but material) motive then that will suffice: see *Kemmis v Kemmis (Welland and Others Intervening), Lazard Brothers and Co (Jersey) Ltd v Norah Holdings Ltd and Others* [1988] 1 WLR 1307, [1988] 2 FLR 223.
>
> (ii) That the execution of the charge had the consequence of defeating her claim. This means preventing relief being granted, or reducing the amount of any such relief, or frustrating or

impeding the enforcement of any order awarding such relief. See s 23(1) and s 23(2)(b).

(iii) That the court should exercise its discretion to set aside the charge. See s 23(2).

(iv) However, under s 23(6) there is an exception to the general rule that all dispositions are liable to be set aside. The disposition in favour of LF will not be set aside if it can be shown at the time it was made that,

a) it was done for valuable consideration; *and*

b) LF acted in relation to it in good faith; *and*

c) LF was without notice of any intention on the part of H to defeat W's claim for financial relief.

[10] The knowledge of LF referred to in para [9](iv)(c) above is not confined to actual knowledge but extends to constructive knowledge: see *Sherry v Sherry and Another* [1991] 1 FLR 307; *Le Foe v Le Foe and Woolwich plc*; *Woolwich plc v Le Foe and Le Foe* [2001] 2 FLR 970. The test for constructive knowledge is well known and derives from the statement of Farwell J in *Hunt v Luck* [1901] 1 Ch 45:

'Constructive notice is the knowledge which the courts impute to a person upon presumption so strong of the existence of the knowledge that it cannot be allowed to be rebutted, either from his knowing something which ought to have put him to further inquiry or from his wilfully abstaining from inquiry, to avoid notice.'

[11] Although there is a formal legal burden on W to demonstrate the negative of the matters referred to in para [9](iv) above, I take the view that for obvious reasons (having to prove a negative; lack of knowledge) there is an evidential burden shifted to LF to establish this exception. If he does not establish all three limbs of the exception then the defence will not arise."

12. On the evidence before me I was wholly satisfied on 2 July 2012 when I made my ruling that:

i) The transaction in December 2010 manifestly had the effect of defeating W's claims for a financial remedy in that they either prevented relief from being granted or had the result that lesser relief would be granted.

ii) H has not demonstrated that he effected the transaction without the intention to defeat W's claims.

iii) It has not been shown that R9 received the shares in good faith and for valuable

consideration and without actual or constructive notice of W's potential claims.

iv) Therefore all of the factual criteria are satisfied.

v) It would be a fair and just exercise of my discretion to set aside the transaction for were I not to do the very vice that s37 is directed towards would be given full rein.

vi) There would be consequential orders under s37(3) to reverse certain subsequent dealings, which are compendiously described in the skeleton argument of Mr Goodfellow QC at paras 2.1 – 2.4

The legal effect of the s37 order

13. Does my order setting aside the transactions and the subsequent dealings operate to annul or avoid them ab initio so that for all legal (including fiscal) purposes they are treated as never having happened? Or does my order recognise the validity of the transactions and operate only to effect a (later) re-vesting anew in H?

14. If it is the former then on the sale of DH any CGT liability will fall directly on H. If the latter then CGT (in a rather less amount, according to Mr Dyer QC and Mr Massey QC) will fall on the Efrbs, and the Directors.

15. I have no doubt at all that it is the former. In my judgment a transaction caught by s37 is plainly a voidable transaction. By contrast, and by design of the draftsman, a transaction caught by s10 Inheritance (Provision for Family and Dependants) Act 1975 is not a voidable transaction but rather a fully valid transaction which, on proof of similar facts to those required by s37, can, in the exercise of discretion, give rise to an obligation to repay. I am told by counsel, who have undertaken deep research, that there is no reported case even touching on the point. One is therefore required to undertake a task of statutory construction, having regard not just to the literal words, but also to the purpose of the legislation. In this regard reference to analogies is inevitable.

16. s37 was first incarnated in s2 Matrimonial Causes (Property and Maintenance) Act 1958. It was re-enacted, with slight changes, in s32 Matrimonial Causes Act 1965, and in yet wider form in s16 Matrimonial Proceedings and Property Act 1970. That was re-enacted unaltered in s37 MCA 1973. From inception it was intended as a bespoke divorce statutory alternative to the equitable right to seek rescission or avoidance of a transaction procured by misrepresentation, and also to the general statutory anti-avoidance measure within s172 Law of Property Act 1925. s172 itself had an ancient pedigree stretching back to the Fraudulent Conveyances Act 1571. The language of s172 could not be more clear. It is intituled "Voluntary conveyances to defraud creditors voidable". Subsection (1) provides "save as provided in this section, every conveyance of property, made whether before or after the commencement of this Act, with intent to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced".

17. s172 has since been replaced by s423 Insolvency Act 1986, in language which eschews the anachronistic and obscure. It speaks of "restoring the position to what it would have been if the transaction had not been entered into" which to my mind says in plain English exactly the same thing as "annulling a voidable transaction". In *Chohan v Saggar* [1994] 1 BCLC 706, CA Nourse LJ explained that Parliament in enacting s423 had intended the court to have much fuller powers than were previously available under s172 of the 1925 Act. Thus it is not restricted to the unitary power of setting aside the whole transaction. Rather, in order to restore the position the court could, where the transaction is made up of a number of component parts, set aside some parts but leave other parts undisturbed.

18. s37 is intituled "*Avoidance of transactions intended to defeat applications for financial relief*". "Avoidance" is the language of nullity not of repayment or re-vesting. Etymologically it refers to the concept of "voidity" (as Wilson LJ coined it in *Radmacher v Granatino* [2009] 2 FCR 645, CA at para 119). So, by s37(2)(c) in order to impose voidity on the transaction the court may make an order "setting aside the disposition". That language would not be apt if the concept was repayment or re-vesting. Instead, it would have said, as s10(2) of the 1975 Act says, that the court may order the disponee "to provide such sum of money or other property as may be specified in the order". It is obvious to me that the draftsman of s10 of the 1975 Act expressly did not want a reversing transaction to operate as an avoidance ab initio, in stark contrast to s37, of which he must have been well aware, as many parts of the 1975 Act are modelled on the 1973 Act.

19. My plain conclusion is that by reference to the literal words of the statute an order under s37 operates retrospectively to void the transaction ab initio. This is fortified by reference to two powerful authorities to which I now refer.

20. In *Kemmis v Kemmis* [1988] 1 WLR 1307 Purchas LJ explicitly recognised the retrospective operation of an order under s37. At page 1315 he stated "by inference, if the necessary intention can be proved, although this will become increasingly difficult with the passage of time, there is no limit provided in the section to its retrospective effect."

21. In *Newlon Housing Trust v Alsulaimen* [1999] 1 AC 313, on 1 November 1995 the wife gave the landlord of the rented home of her and her husband notice to quit the premises expiring on 4 December 1995. The effect of the notice was to bring the tenancy to an end on that date. After that point there was no property which could be re-vested in the parties. The tenancy had ceased to exist. The House of Lords had to consider whether, for the purposes of s 37 MCA, the service of the notice to quit was a "disposition of property" which could be set aside.

22. Lord Hoffmann considered the meaning of "disposition" and the restorative power of the set-aside order. He stated at p316H-317C:

> "The question is therefore whether the termination of a tenancy can be a disposition of property. 'Disposition' is a familiar enough word in the law of property and ordinarily means an act

> by which someone ceases to be the owner of that property in law or in equity: see the formulation by Mr R.O. Wilberforce QC in *Grey v Inland Revenue Commissioners* [1960] AC 1, 18. In some contexts it may include the case in which the property ceases to exist. It is unnecessary to decide whether it has such an extended meaning in this case. There are contrary indications, namely that s.37 contemplates, first, that the disposition will be capable of being set aside and secondly, that the beneficiary of the disposition may be able to show that he took in good faith and without notice. On the other hand, I feel sure that 'disposition' was intended to include the surrender of a subsisting proprietary interest, such as a tenancy for years or for life, so as to merge in the reversion or remainder: see *Inland Revenue Commissioners v Buchanan* [1958] Ch 289 per Lord Goddard CJ at 296. But, be that all as it may, I think it is essential to the notion of a disposition of property in this context that there is property of which the disponor disposes, whether to someone else or not. **It is this property which the court can restore to his estate by setting aside the disposition"**. (emphasis added)

In my opinion the "restorative" power of the set aside order referenced by Lord Hoffmann is wholly consistent with the concept of the original disposition being rendered void ab initio.

23. The fact that an order under s37 operates to avoid a transaction ab initio does not mean that innocent third parties who have subsequently acquired the property in question in good faith will be prejudiced. Put another way, avoidance ab initio can co-exist with the preservation of subsequently completed transactions entered into in good faith. As will be seen, this is reflected in comparable situations in old cases concerning the effect of a decree of nullity of marriage, and also in the cases involving the equitable right of rescission. This co-existence was expressly recognised in a s37 case in *Ansari v Ansari* [2010] Fam 1 where Longmore LJ stated at para 22:

> "I am however, clear that [s37(3)] should not be used in the circumstances of the present case since there is no question at all of the bank being a party to any conspiracy or even (as I have already said) having notice of any intention on the part of the husband to defeat the wife's rights. The discretion conferred by subs (3), even if it can be used to set aside dispositions subsequent to the first disposition in a case where the parties acted in bad faith, should certainly not be used to set aside a subsequent disposition for valuable consideration to a person who acted in relation to it in good faith and without such notice."

Analogies

24. Mr Le Grice QC cautions me not to be drawn into making comparisons with the distinctions between void and voidable marriages. I shall do so nonetheless, not just because it is a field in which I feel confident, but because the old cases do provide some

interesting insights into the issue with which I am presented. The distinction between void and voidable marriages is explained with characteristic scholarship by Joseph Jackson QC in his seminal book *The Formation and Annulment of Marriage* (2nd edition, Butterworths, 1969) at pages 98 – 127. Many financial disputes were fought over the effect of an order which decreed the annulment of a voidable marriage. Thus in *P v P* [1916] 2 IR 400 the question was whether a woman who had paid a dower of £475 in consideration of her marriage could recover it when the marriage was later annulled on the grounds of the husband's impotence, a defect which rendered the marriage voidable, but not void. The husband had used £400 to pay off a charge on his lands, and had spent £75 on living expenses. Madden J held, and the Court of Appeal agreed, that the decree of nullity operated ab initio in relation to the £400, which the wife was entitled to recover, but as regards the spent £75 this "was a concluded transaction by which both parties benefited, and ought not now to be disturbed". Sir Ignatius O'Brien LC reasoned the decision as regards the £75 as a form of estoppel operating against the wife.

25. An interesting case in the present context, as it involved the Inland Revenue, was *Dodworth v Dale* [1936] 2 KB 503. There a husband obtained a nullity decree on the ground of his wife's inability to consummate the marriage in 1933. As Jackson puts it "an enterprising Inspector of Taxes claimed the payment by the husband of the difference between a married and unmarried man's personal tax allowance for tax purposes for the years 1928 to 1933 inclusive". Lawrence J held at page 511 that "a marriage which is null on the ground of the incapacity of one of the spouses is voidable and not void; but when avoided, it is void ab initio but not for all purposes". At page 512 he stated "things which have been done, during the period of the supposed marriage, cannot be undone or reopened after the marriage had been declared null and void". The Crown's claim for repayment therefore failed.

26. Similar controversies arose in relation to *dum vidua* clauses in wills. In *Re Dewhirst* [1948] Ch 198 Harman J described the problem as "a point of some nicety". Income was left in a will to the deceased's widow until she remarried, in which event half of the income would continue to go to her. She remarried (and the income fell by half) but she later obtained an annulment of the second marriage on the grounds of her second husband's inability to consummate. Was she entitled to the other half of the income from the date of her second marriage? Harman J decided that she was and that the second marriage should be treated "for all purposes as never having happened" (at page 206). In reaching that decision he adverted at page 205 to an apparent difference of judicial opinion on the subject, but sought to reconcile them by saying "it is one thing to say that a person is entitled to property or rights after the annulment of the marriage, but it is quite another thing to upset transactions, completed or made permanent, while the marriage was current".

27. The differing financial treatments of a voidable marriage were all brought to an end by the passage of s5 of the Nullity of Marriage Act 1971 (now s16 MCA 1973) which provides that "a decree of nullity granted after 31st July 1971 in respect of a voidable marriage shall operate to annul the marriage only as respects any time after the decree has been made absolute, and the marriage shall, notwithstanding the decree, be treated as if it had existed up to that time."

28. It can thus be seen that the reasoning in para 22 of *Ansari* whereby avoidance ab intio co-exists with the preservation of concluded, good faith, third party transactions, has a long historical reflection in the old nullity cases. It also chimes with the way in which the equitable remedy of rescission has been operated. The first base is that rescission operates to avoid the transaction ab initio. In *Lonhro Plc v Fayed & Ors (No 2)* [1992] 1 WLR 1 at paras 11-12 Millet J (as he then was) stated:

> "A contract obtained by fraudulent misrepresentation is voidable, not void, even in equity. The representee may elect to avoid it, but until he does so the representor is not a constructive trustee of the property transferred pursuant to the contract, and no fiduciary relationship exists between him and the representee: see Daly v. Sydney Stock Exchange Ltd. (1986) 160 C.L.R. 371 , 387–390, per Brennan J. **It may well be that if the representee elects to avoid the contract and set aside a transfer of property made pursuant to it the beneficial interest in the property will be treated as having remained vested in him throughout, at least to the extent necessary to support any tracing claim.** But the representee's election cannot retrospectively subject the representor to fiduciary obligations of the kind alleged. It is a mistake to suppose that in every situation in which a constructive trust arises the legal owner is necessarily subject to all the fiduciary obligations and disabilities of an express trustee. Even after the representee has elected to avoid the contract and reclaim the property, the obligations of the representor would in my judgment be analogous to those of a vendor of property contracted to be sold, and would not extend beyond the property actually obtained by the contract and liable to be returned." [emphasis added]

See also *Bristol and West Building Society v Mothew* [1998] Ch. 1 at 23 where Millet LJ stated:

> "The right to rescind for misrepresentation is an equity. Until it is exercised the beneficial interest in any property transferred in reliance on the representation remains vested in the transferee. In [an earlier first instance authority] I suggested that on rescission the equitable title might revest in the representee **retrospectively** at least to the extent necessary to support an equitable tracing claim. I was concerned to circumvent the supposed rule that there must be a fiduciary relationship or retained beneficial interest before resort may be had to the equitable tracing rules." (emphasis added)

29. That is not to say that certain third party rights would not be protected. In *Shalson v Russo* [2005] Ch 281 Rimer J (as he then was) stated at para 122:

> "Rescission is an act of the parties which, when validly effected, entitles the party rescinding to be put in the position he would have been in if no contract had been entered into in the first place.

> It involves a giving and taking back on both sides. If it is necessary to have recourse to an action in order to implement the rescission, the court will make such orders as are necessary to put both contracting parties into the position they were in before the contract was made. There is, however, also a line of authority supporting the proposition that, upon rescission of a contract for fraudulent misrepresentation, the beneficial title which passed to the representor under the contract revests in the representee. The representee then enjoys a sufficient proprietary title to enable him to trace, follow and recover what, by virtue of such revesting, can be regarded as having always been in equity his own property. This may be an essential means of achieving a proper restoration of the original position if the representor has in the meantime parted with the property and is ostensibly a man of straw unable to satisfy the court's orders for restoration of the original position."

And at para 126:

> "Until rescission, the property is vested in the representor; and if it is disposed of to a good faith purchaser, that purchaser will obtain a title which will be unimpeachable after any rescission. Such purchasers would include the representor's chargees."

30. So it can be seen, again, that the equitable remedy of rescission operates in exactly the same way as an order under s37. As between the parties it annuls the transaction ab initio, but bona fide concluded third party transactions will not be disturbed.

A different rule for tax?

31. The law of tax is not an island entire of itself. Unless a taxing statute says to the contrary the right of the state to charge tax in relation to a given transaction is subject to the effect of that transaction as defined by the general law. In the specific context with which I am concerned there is long-standing authority from the Court of Session (First Division) in Scotland, *IRC v Spence* (1941) 24 TC 312, never doubted in subsequent tax cases in the English Courts, which says that the tax effects of a transaction will be annulled retrospectively if it is subsequently found to be voidable, and is declared void. The case concerned the tax implications following a share sale transaction carried out by the taxpayer, Spence, which was subsequently declared void. Spence had entered into and completed a contract to sell shares to a purchaser, Crawford. Crawford had then received the dividends. 6 years later, Spence was successful in an action to have the share sale declared void on grounds of Crawford's fraudulent misrepresentation. Crawford was ordered to retransfer the shares, Spence accounting to Crawford for the price, interest thereon, and half the increase in value since transfer. Crawford was also ordered to repay the dividends received since the original transfer less the income tax he had paid on them. The Inland Revenue repaid Crawford the income tax he had paid to them, and assessed Spence on the dividends for each of the years in question, giving him relief for the interest paid. Spence appealed against the assessment, claiming that the amount paid by Crawford to him was not actual dividend income of his but

compensation for the dividend income out of which he had been defrauded. The Special Commissioners and on appeal the First Division of the Court of Session rejected his appeal. Lord President Normand giving the leading judgment, said at page 316:

> "There is, therefore, sharply raised a question whether, when the reduction took place, the result of it was that [Spence] fell to be dealt with as having been the recipient of the dividends in the years in question and therefore bound to pay Income Tax upon them, or whether the legal result is that [Spence] was really in receipt of a lump sum, being a surrogatum for the dividends or some sum calculated by the amount of the dividends but not in itself being an annual income of [Spence], and that is I think the sole question before us…….
>
> **Now, a distinction was drawn by the learned Counsel for [Spence] between void and voidable actions, and of course there is a well recognised difference. In this case the contract was not void; it was merely voidable on the ground that it had been induced by fraudulent misrepresentations. When a contract has been induced by fraudulent misrepresentations, it is open to the party defrauded either to sue for rescission of the contract or to sue for damages. In this case the party sued for rescission and in the end of the day he obtained a decree of reduction. The effect of that reduction was to restore things to their position at the date of the transaction reduced, with the result that as at that date and afterwards the successful Pursuer in the action fell to be treated as having been the person in titulo of the shares which he had sold to the Defender and therefore to have been in right of the dividends.** No doubt it is true that in the interval the dividends had to be paid and were paid to the Defender because his name stood in the register as the proprietor of the shares and no doubt also they were for the time being treated by the Inland Revenue as his income and while matters stood entire no other person had any right to the shares or to the dividends except the Defender, Mr. Crawford. But from the moment the reduction took place Mr. Spence fell to be treated as having been throughout the proprietor of the shares and equally the person properly entitled to receive the dividends. On the other hand the Inland Revenue repaid to Mr. Crawford the Sur-tax attributable to the dividends actually paid to him by the company on the footing that he had never been in titulo to receive them. In my opinion the way in which the statement of accounts which was laid before the House of Lords was made up is in exact accord with that situation…. It was said by the Counsel for [Spence] that what his client received as the result of the decree was not the dividends but compensation for the dividends, something in the nature of damages measured by the value of the dividends as they had accrued in past years. Of course, it is often necessary for a Court to estimate damages by reference to loss of income in a series of years, and when it does so the resulting amount of damages which is awarded to the

> successful party is a lump sum capital payment in place of income payments which he might have received annually. … But payments of that sort, payments of damages or payments of compensation, are in no way similar to the payments with which the Appellant was credited in the statement of account between him and Mr. Crawford submitted to the House of Lords. The fact is that the only title which the Appellant could put forward to demand these payments at all was that he was the person in right of the shares at the time the dividends were declared, and therefore the person in right of the dividends. That was the basis of his legal claim for reduction and it was that legal claim to which effect was given by the judgment of the House of Lords and the subsequent Interlocutor of this Division. In my opinion what he received was the dividends and not a surrogatum of the dividends. It was not compensation for loss of the dividends nor was it damages for loss of the dividends. It was just the dividends which, one may say, Mr. Crawford received and had for the person whom he had defrauded". (emphasis added)

32. I have been referred to a number of authorities which make it clear that an order which is retrospective as a matter of general law will be retrospective for the purposes of the tax codes. See, for example, *Racal Group Services Ltd v Ahsmore and others* [1995] STC 1151, *Wills v Gibbs* [2007] EWHC 3361 (Ch), *Wolff v Wolff* [2004] EWHC 2110 (Ch), and *Sieff v Fox* [2005] EWHC 1312(Ch). I have also been referred to authorities that show that HMRC (or its predecessors) has never sought to argue against the view that an order which is retrospective as a matter of general principle will not be retrospective for any fiscal purposes. See, for example, *Toronto-Dominion Bank v Oberoi* [2002] EWHC 3216 (Ch) and *Wolff v Wolff* (supra). Indeed in *R v Inspector of Taxes, ex parte Bass Holdings Ltd and a related application* [1993] STC 122 the Commissioners of the Inland Revenue themselves sought and were granted an order for rectification of a settlement contract they had entered into with a taxpayer under the provisions of s. 54 Taxes Management Act 1970. Popplewell J in granting the order for rectification sought by the Inland Revenue considered that the order would have the retrospective effect of bringing into charge to tax amounts which absent the retrospectivity of the order would have escaped charge to tax by virtue of the excessive amounts of group relief erroneously conceded in the settlement contract.

33. Counsel, pursuant to their duty to bring to my attention any contrary arguments adverse to their stance, have referred to two matters: first, the terms of s150 Inheritance Tax Act 1984 ("IHTA"); and, second, the decision of the Court of Appeal in *Morley-Clark v Jones (Inspector of Taxes)* [1985] STC 660.

34. s150 IHTA provides that where a chargeable transfer is set aside as being voidable, the same IHT consequences follow as if the transaction had been void ab initio. It also provides that the IHT treatment of subsequent chargeable transfers will be adjusted to take account of the fact that a voidable transfer of value has been avoided. There is no corresponding provision for capital gains tax, or for any other tax, which expressly treats a voidable transaction for tax purposes as if it had been void ab initio. The existence of the IHT provision (s.150 IHTA) raises the question as to why it was thought necessary to

enact the provision, if the law already produced the same effect independently of the provision. It might also be argued, on the principle inclusio unius est exclusio alterius, that if the provision is explicitly there for IHT Parliament by not enacting a corresponding provision for any other form of tax intended that it should not apply to those other taxes.

35. I am satisfied for two reasons that these concerns are unfounded. To my mind Mr Ewart QC and Mr Rivett have convincingly explained that s150 is no more than a piece of machinery which needed to be inserted in the IHTA in circumstances where the general tax management machinery in the Taxes Management Act 1970 ("TMA") does not apply to Inheritance Tax. Under ss33, 42, Sch 1A and 1AB TMA there are wide provisions for the recovery of income tax and capital gains tax paid on the basis of an error or mistake and for the recovery of overpayments of tax. I therefore agree with their submission that:

> "…the simple function of s. 150 IHTA 1984 is to make provision for the recovery of inheritance tax paid or owing on the basis of a court order which takes retrospective effect or where a transaction is defeasible. It is no wider than that, and nothing adverse can be drawn from the point that no equivalent provision is contained within the separate legislative code of the TCGA 1992. "

36. The second reason is that it may be a false supposition to accept that tax legislation is drawn up completely consistently, and that the draftsman of s150 IHTA would have had specifically in mind that there was no corresponding provision in the same terms for other taxes in other taxing statues. Mr Goodfellow QC has plausibly submitted that little assistance is to be obtained from a comparison of different statutory provisions in different Acts or from the inclusion of express deeming provisions in one tax code and the absence of any equivalent in another tax code. The UK tax code is so vast and so complex that it would be a pure fiction to proceed upon the basis that Parliament was familiar with all the provisions it had enacted over hundreds of years or that the Parliamentary draftsman must have had in mind the provisions of a different tax code, when drafting another and so must have made a conscious decision not to include a particular provision.

37. In *Morley-Clarke v Jones* [1986] Ch 311, CA Mr Registrar Rowe, sitting in the Divorce Registry, exercising his powers pursuant to s31 MCA 1973 and varied by consent an order for child maintenance (of £2.50 per week) with back-dated effect, so that from a past date the maintenance was ordered to be paid direct to the child and not to the former wife. The purpose of the variation was to make the maintenance payments the income of the child rather than the income of the wife, and so improve the income tax position. The wife sought repayment of income tax on the maintenance payments for the past tax years on the grounds that, as a result of the variation order, the payments were to be treated as not her income but that of the child. Her argument prevailed in the High Court, but on appeal the Court of Appeal held that the order under s31 back-dating the variation could not alter the position for tax purposes in the years before the variation. The maintenance had in fact been paid to the wife in the years in question, and spent by her. It was therefore her income in those years, notwithstanding the variation order. Oliver LJ distinguished *Spence v IRC* saying at p331 H :

> "A retrospective order cannot, any more than a retrospective agreement, undo the past and convert something that has already happened, and as to which legal consequences have already attached, into something which never in fact did happen…"

And at page 332 F-G:

> "Once the transferor in [Spence] had elected to avoid the contract, there was no contract in existence and it followed that the shares were his property and that any dividends received were held by the recipient as a trustee for him. The restitutio in integrum represented by the court order obtained some years later did not so much reconstruct history as recognise and declare that which had all along been the legal position, although until the order the parties were in a state of some uncertainty as to what their rights were."

38. To my mind there is a world of difference between an order setting aside a voidable transaction caught by s37 and making a back-dated variation of a valid child maintenance order, which had been fully paid, and taxed in the hands of the wife. By definition an order under section 37 has the effect of 'setting aside' the impugned transaction as against the world since it involves a disposition by the disponor to a disponee who is not the applicant. In contrast, a variation of a maintenance order, even if expressed to be retrospective, only alters the obligations of the parties inter se. I agree with the submission of Mr Goodfellow QC that:

> "The key fact in *Morley-Clarke v Jones* was that the original order was perfectly valid and effective and the new maintenance order was not in any way avoiding a transaction which had a vitiating feature ab initio. It was for that reason why the new order could not re-write history for tax or any other purpose. In the present case, due to the presumed tainted purpose of the transactions, they were always at risk of being avoided or set aside by the Court. HMRC was no more or less a party to or affected by the maintenance orders in *Morley-Clarke v Jones* than it is a party to or affected by any transaction, which unless avoided, might give rise to a charge to tax."

39. While I am grateful to counsel for dutifully drawing these two concerns to my attention I am satisfied that neither derogates from my clear conclusion that my order operates to annul the transactions ab initio. There are no subsequent purchases by, or disposals to, bona fide third parties which require to be left undisturbed.

Policy

40. Finally, I turn to the question of policy. If the power to set aside a reviewable disposition were not (at least) capable of reversing the legal effect of the reviewable disposition

sufficiently so that tax charges which had arisen as a result of (or during) the (albeit temporary) validity of the reviewable disposition and/or subsequent dealings, the purpose of s37 (to preserve the assets of the family) would likely be frustrated in part. If such tax liabilities survived the setting aside of a transaction, they would frequently end up being attached to the disponor, or to the assets disposed of, and so diminish the disponor's resources and the Court's ability to restore the status quo ante. This is because the disponee would find himself not only deprived of an asset but also exposed to a capital gains tax charge on any chargeable gains crystallised in respect of that asset on his disposal of it (i.e. by reference to the growth in value of the asset between the date of its acquisition by the disponee and his subsequent disposal of the asset pursuant to the order under s37). The disponee would therefore demand to be able to recoup out of the assets before returning them, or would want a full indemnity.

41. I agree with Mr Goodfellow QC's submission that there is no public policy reason why a third party (HM Treasury) should benefit from the brief life of transactions which have for all other purposes been set aside, particularly when that benefit is at the cost of the family's assets.