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UK tax analysis: refresher on beneficial ownership

Beneficial ownership and entitlement are pervasive concepts in tax law. The Court of Appeal's decision in *Hargreaves* offers an opportune reminder of the domestic meaning of these terms, including that they are susceptible to purposive construction. Artificial arrangements leaving the owner with nothing more than a legal shell will not therefore survive judicial scrutiny. The judgment also plainly states that there is a difference between the domestic and international fiscal meanings. The latter has followed a separate course, having become a seemingly more demanding standard that is increasingly entwined with modern anti-avoidance philosophy. Some areas of tax law where we commonly see the beneficial ownership concept in practice are withholding taxes, tax grouping rules in insolvency and M&A contexts, and stamp taxes.

"Beneficial ownership" and "beneficial entitlement" are pervasive concepts in UK tax legislation. They determine *inter alia* whether companies are in the same tax group and, as discussed by the Court of Appeal (***CA***) recently in *Hargreaves Property Holdings v Revenue and Customs* [2024] EWCA Civ 365, whether tax should be withheld from interest payments. Some of the most common examples of where beneficial ownership and beneficial entitlement crop in practice are set out in the table to the right.

In dismissing the taxpayer's appeal, the CA did not need to break new ground. However, Falk LJ's judgment offers a pithy refresher of previous case law on beneficial ownership.

This article revisits the familiar ground retraced by the CA in *Hargreaves* and considers some of its practical applications.

Tax concept	Statutory provision	Language
Group/consortium relief	Part 5 CTA 2010	"Beneficially owned" "Beneficial entitlement"
CGT groupings	Section 170 TCGA 1992	"Beneficially owned" "Beneficial entitlement"
Substantial Shareholding Exemption	Para 8(1), Sch 7AC TCGA 1992	"Beneficially entitled"
Stamp taxes	Section 42 FA 1930	"Beneficial owner" "Beneficially entitled"
	New sections 72ZB and 97AC FA 1986	"Beneficial ownership"
Withholding taxes	Sections 879 and 933 ITA 2007	"Beneficially entitled"
Double taxation treaties	Interest, dividend and royalty articles	"Beneficially owned" "Beneficial owner"

Beneficial ownership under English law

Hargreaves concerned whether loan interest paid to a UK resident company (Houmet) qualified as an excepted payment under section 933 of the Income Tax Act (***ITA 2007***). The CA held it did not because Houmet was not beneficially entitled to the interest, such that withholding tax was required to be deducted by the borrower under section 874 ITA 2007. The conclusion was unsurprising given the apparently artificial planning undertaken by the taxpayer in its attempt to secure a corporation tax deduction for interest expense with no corresponding inclusion and no withholding obligation. The taxpayer failed in its quest because it had provided extremely limited evidence about Houmet, its role in the arrangements and whether it retained any of the benefits that might be derived from any entitlement to the interest. This resulted in the "inescapable conclusion on the facts" that the only reason for Houmet's involvement was to secure a UK tax advantage and that no benefits of ownership of the interest receipts were conferred on it.

Although she did not need to do so, Falk LJ helpfully took the opportunity to remind practitioners of the key principles and cases underlying the beneficial ownership concept.

Domestic law meaning: ownership with (at least some) benefits versus mere legal shell

Hargreaves reminds us that beneficial ownership and beneficial entitlement under UK domestic law are interchangeable: each concept concerns ownership "for the benefit of the person in question" or "ownership with benefits". Per the CA's decision in *Wood Preservation v Prior* (1969) 45 TC 112, that must include "the right at least to some extent to deal with the property as your own". A "mere legal shell" is not enough.

Wood Preservation concerned claims for group relief in connection with a conditional share sale. The subsidiary companies being sold sought to access trading losses of the parent for the period prior to the condition being waived (having accepted that beneficial ownership is lost once the sale contract became an unconditional contract). The findings of fact however were against the taxpayer. Although the sale contract was conditional, the parent could not derive any economic benefits from shares in the subsidiary companies and was compelled to transfer them to the purchaser as soon as the condition was satisfied (or waived) at the purchaser's option. Accordingly, while the parent company remained the legal owner, it retained a "mere legal shell", having "parted with everything" apart from legal ownership, leaving it "tied hand and foot". In those circumstances, the parent did not retain beneficial ownership. As a result, the subsidiaries could not access the parent's trading losses.

The CA in *Hargreaves* revisited three other key cases that considered beneficial ownership in the context of group or consortium relief claims: *Ayerst v C & K (Construction) Limited* [1975] STC 345, *J Sainsbury plc v O'Connor* (HMIT) [1991] STC 318 and *Bupa Insurance Limited v HMRC* [2014] STC 2615.

Ayerst confirmed that beneficial ownership is lost when a company enters liquidation. The House of Lords affirmed, following a "consistent line of judicial authority" that a company in liquidation loses beneficial ownership of its assets and thereby loses any group relief relationship with its subsidiaries. *Ayerst* is also authority for the proposition that beneficial ownership can be lost by an owner, even if it does not vest anywhere else. So there may be cases where no-one retains sufficient benefits of ownership to qualify as a beneficial owner.

Sainsbury v O'Connor considered the effect of put and call options. Sainsbury had entered into put and call options over its shares in the Homebase joint venture, which had the effect of splitting economic ownership 70:30 whilst leaving Sainsbury with 75% of the share capital. HMRC argued that Sainsbury could not access group relief because it did not have beneficial ownership over the necessary 75% of the joint venture company's share capital by virtue of the cross put and call options. The CA disagreed because Sainsbury remained the equitable owner of the shares and retained at least some of the benefits of ownership, including the right to dividends. Sainsbury may not have retained all of the ownership benefits, but it retained enough of them.

Bupa concerned whether a shareholder seeking consortium relief was beneficially entitled to the requisite percentage of distributed profits or assets distributed on a winding up. Bupa had acquired 46.8% of the shares in a joint venture company but had contractually agreed to pay earn out consideration to the seller equal to 100% of any distribution received up to an agreed hurdle (and to pay 95% thereafter) within 10 days of any distribution being paid. Notwithstanding the contractual arrangements, the Upper Tribunal found that Bupa retained more than a mere legal shell because it was not a trustee and could choose to spend the distribution received and otherwise fund the onward payment to the seller. It was also exposed to currency fluctuations and entitled to any return on the distribution proceeds during the 10 day period. It therefore retained at least some of the benefits (and risks) of ownership, notwithstanding the onward payment obligations. An obligation to pay on "very similar sums" to those received is not therefore fatal to a claim for beneficial entitlement, at least under the domestic law test, as long as some risk and reward is retained.

Imperfect overlap with equitable ownership

There is a significant degree of overlap between beneficial ownership and equitable ownership. A nominee or bare trustee is not a beneficial owner, and a trust was described by Lord Diplock in *Ayerst* as the archetype of a situation where legal ownership "did not carry with it the right of the owner to enjoy the fruits of it or dispose of it for his own benefit". Conversely, a purchaser under a specifically enforceable contract can have beneficial ownership of the asset concerned (as confirmed by the High Court in *Parway Estates Ltd v IRC* (1957) 45 TC 135). However, *Hargreaves* reminds us that the concepts of equitable and beneficial ownership are not entirely co-extensive, including because beneficial ownership (even applied in a domestic context) needs to be capable of operating in legal systems without similar legal traditions, such as Scotland (as pointed out in *Bupa Insurance v HMRC* [2014] STC 2615).

Narrower concept than "receiving or entitled to"

Hargreaves also makes clear that beneficial entitlement is a narrower concept than mere entitlement or belonging. The CA distinguished its relatively recent decisions in *Boston Khan v HMRC* [2021] STC 954 and *Thomas William Good v HMRC* [2023] STC 301 on the basis that both concerned taxing provisions imposing a charge on the person "receiving or entitled to" income, which is a broader concept, extending beyond beneficial entitlement. Falk LJ did however note that the taxpayers in both of those cases derived real financial benefits from the payments made to them, suggesting they would have satisfied the domestic law test of beneficial entitlement had that been the question under consideration.

Purposive approach to statutory construction applies

Hargreaves also confirms (to the extent it was in doubt) that beneficial ownership/entitlement may be legalistic concepts but they are not immune from purposive construction. In that respect, the CA's decision also offers a useful refresher on principles of purposive construction and the need to consider whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically (per *BMBF v Mawson* [2005] STC 1, *UBS AG v HMRC* [2016] STC 934 and *Rossendale BC v Hurstwood Properties (A) Ltd* [2021] UKSC 16).

And there was a pointed reminder of the House of Lords decision in *Scottish Provident Institution (SPI) v IRC* [2005] STC 15, in which self-cancelling cross-options were disregarded notwithstanding the element of commercial risk retained. Viewed in the context of the larger scheme, the level of risk retained by SPI was a "commercially irrelevant contingency". That remains a point to keep in mind in a tax planning context where the retained ownership benefits are not material.

Differs from international fiscal meaning

A key point on which the CA in *Hargreaves* diverged from the Upper Tribunal was in putting *Indofood International Finance v JP Morgan Chase Bank* [2006] STC 192 firmly back into its box. *Indofood* considered the meaning of beneficial ownership in the context of a double tax treaty, finding that it requires "full privilege to directly benefit from the income". Conceptually, this test sets a higher bar than that deriving from the case law traversed in *Hargreaves*. *Hargreaves* confirmed that the approach taken by the CA in *Indofood* is only relevant in a double tax treaty context; the domestic law meaning is different.

Clearly there is a high degree of overlap. Ownership that amounts to nothing more than a "mere legal shell" will not satisfy either the domestic law test or the international fiscal meaning. However, whilst the international fiscal meaning requires "full privileges" of ownership to be retained, the domestic law meaning remains more lenient and beneficial ownership will only be lost if the owner has not retained "any of the benefits of ownership". In practice, though, the conceptual differences between the two approaches may not manifest in different results. Recall that the recipient of interest payments in *Indofood* was found to be its beneficial owner; and the Canadian courts, for example in *Prevost Car Inc. v The Queen* 10 ITLR 736 and Velcro *Canada Inc. v The Queen* 14 ITLR 613, have previously been unwilling to find that a recipient of a payment is not its beneficial owner, even where the receipts are contractually required to be passed on, unless the recipient has absolutely no discretion in the matter. Compare these decisions with the UK domestic case of *Bupa*, and one might fairly question how often the domestic and international approaches would produce different results in practice.

More recently, however, the concept of "beneficial ownership" has been a vessel for the application of anti-abuse principles, with the "Danish Cases" (Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16) having become a key landmark in this area. In those cases, non-EU investment funds granted loans to Luxembourg vehicles, which on-lent the funds to a Danish company. The question under consideration was whether the Danish company was entitled to pay interest to the Luxembourg vehicles free of withholding tax under the Interest and Royalties Directive. The Danish tax authorities (invoking a principle of "beneficial ownership" not previously known to Danish law) argued it was not because the Luxembourg vehicles were not the beneficial owners of the interest and the actual beneficial owners were not entitled to the withholding tax exemption (as they were not resident in the EU). The CJEU

agreed and provided guidance on the circumstances in which relief may (or indeed must) be denied, which included where abusive practices are employed. The application of anti-abuse principles may be justified where double tax treaties are concerned: at least for treaties amended by the Multi-Lateral Convention, the prevention of fiscal abuse is expressed to be a purpose of the treaty. It was less obvious that this approach was justified based on the wording of the Interest and Royalties Directive. Nevertheless, the CJEU in the Danish Cases (to some extent following in the footsteps of the French Conseil d'Etat decision in *Ministre de l'Economie des Finances et de l'Industrie v Société Bank of Scotland*, (2006) N° 283314, 9 ITLR 683) felt able to reach this conclusion through an application of the general EU law abuse of rights doctrine.

Practical application

Bearing in mind some of the principles above, we have set out below some other areas of tax law where we commonly see the beneficial ownership concept in practice and some of the points to keep in mind.

Withholding taxes

Beneficial entitlement is a key condition to various domestic law exemptions from withholding tax (in particular for interest paid to banks or to UK resident companies under sections 879 and 930/933 ITA 2007 respectively). *Hargreaves* confirmed, to the extent it was not already clear, that to qualify for those exemptions, the recipient must therefore retain at least some of the risks and rewards of ownership; it must not be a mere conduit. HMRC identify capital market (including securitisation) vehicles, debt funds, and syndication/sub-participation arrangements as being potentially vulnerable to challenge on these grounds. In each of those cases, there may be a concern that funds flow through the recipient of the interest, such that it is not beneficially entitled to interest received. New York law sub-participations can be particularly problematic as they are typically set up to ensure the sub-participant (not the lender of record) has beneficial ownership in the underlying debt claim. By contrast, English law sub-participation agreements (if properly drafted) will not generally prevent the lender from being beneficially entitled to the interest for the purposes of domestic law exemptions; they can however be more problematic when considered through an international lens or in cases where the arrangement has been structured for tax rather than commercial reasons.

In the international context, where treaty relief is sought, HMRC continue to insist that beneficial ownership requires 'the sole and unfettered right to use enjoy or dispose of' the asset or income. But borrowers may take a degree of comfort from HMRC guidance: they say that the beneficial ownership concept will be invoked only in limited circumstances, 'where a person does not have the full right to directly benefit from income because of an obligation to pass it on to another person'. HMRC also concede that they will not challenge cases where the ultimate beneficial owner would anyway benefit from treaty relief. It may therefore be that a pragmatic view can be taken provided there is no obvious treaty abuse in play. However, following the Danish Cases, care should be taken when lending into Europe: some European tax authorities at least have been encouraged by these cases to interrogate the purpose and substance of different entities in the structure, as well as considering the extent and scope of the ownership rights retained by the putative owner, when assessing eligibility for withholding tax reliefs. And whilst this ought in principle to be the lender's concern, in practice it is often the borrowers who are the most exposed, particularly if they have not adequately tested the status of their lenders before committing to pay interest gross.

Beneficial ownership risks also arise in an M&A context, e.g. when purchasing a European target company from a special purpose holding company located in an EU or treaty state. The purchaser may be at risk if the target is assessed for withholding tax on historic interest or dividends paid to the seller. Obviously the purchaser would hope to have indemnity protection from the seller but, if that is not available, the purchaser may at least need access to information from the seller to demonstrate that it was the beneficial owner of any historic payments received from the target, and was therefore entitled to relief from withholding tax. The purchaser may also want access to information on the seller's ownership structure in order to determine whether relief (at least to some extent) might alternatively be available on a "look through" basis. However, very often (at least in a fund context), this type of information will be commercially sensitive and/or difficult to obtain and tax authorities may be reluctant to agree to a "look through" approach without compelling evidence on the ownership structure.

Tax grouping rules in insolvency and M&A contexts

Beneficial ownership and entitlement also underpin many of the UK tax grouping provisions. A company will only be grouped with its subsidiary for group relief, CGT and stamp duty purposes if it has a threshold level of beneficial ownership of the ordinary share capital in the subsidiary (typically, 75%). Over time, many of those tests have been overlaid with additional requirements to access relief, such as economic ownership requirements (aka equity holder tests) or there being no "arrangements" in place whereby shareholders in the relevant group company might lose their ability to control it. However, a parent company losing beneficial ownership in a subsidiary is of itself enough to break many group relationships.

Maintaining beneficial ownership between group members can be particularly challenging in insolvency settings, where the appointment of an administrator or receiver (or in some cases, the existence of a company voluntary arrangement) might result in the group being broken up or down the ownership chain (or the company in financial distress being deemed to dispose of its assets). However, seller groups engaged in M&A transactions should also tread carefully when determining the point at which beneficial ownership passes to a purchaser and a tax group is broken as in some cases the timing might be unexpected (e.g. where conditions precedent are satisfied quicker than expected). These risks can in some cases be reduced by the parties entering into put and call options (i.e. cross-options) over the shares to be sold. Nevertheless, care should be taken with cross-options which may be perceived as artificial and/or that form part of a wider tax avoidance arrangement (e.g. as in *IRC v Scottish Provident* [2004] UKHL 52 or *Gemsupa v HMRC* [2015] UKFTT 97) or where exercise of the options by one of the parties might be seen as a fait accompli from the outset.

Stamp taxes

The phrase "beneficial ownership" occurs in stamp tax contexts too. It has long been accepted by HMRC that an agreement to transfer mere legal title involving no change in beneficial ownership is not one that can be subject to stamp duty reserve tax. Here, we are really looking at a transfer of beneficial title – i.e. equitable ownership. *Hargreaves* is not therefore directly on point, but there is clearly significant overlap between the concepts, such that it may remain a useful guide as to the circumstances in which beneficial title may be thought to be lost or transferred. This may be particularly relevant to the relatively new "exempt listing transfers" and "exempt listing instruments" concepts introduced by the Finance Act 2024.

Conclusion

Beneficial ownership pervades domestic and international tax law, and *Hargreaves* reminds us not to lose sight of the principles underpinning it. It also helpfully distinguishes the domestic and international meanings of "beneficial owner" and, in doing so, discourages the encroachment of anti-avoidance-driven principles into the domestic domain. However, those principles (and the vigour with which tax authorities are presently predisposed to apply them) must not be overlooked in cross-border structures – particularly those where the money clearly flows through one or more conduit entities, or where the presence of an entity in a given jurisdiction is hard to explain.

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