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Beneficial ownership and abuse – even more

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Friday, May 31st, 2024

The recent English Court of Appeal decision in *Hargreaves Property Holdings Ltd v HMRC* [2024] EWCA Civ 365 http://www.bailii.org/ew/cases/EWCA/Civ/2024/365.html has again examined the meaning of beneficial ownership and the related expression "beneficially entitled" in UK domestic tax law. It follows shortly after the Tax Court of Canada decision in *Husky Energy Energy Inc. v The King,* 2023 TCC 167),discussed in my two previous blogs on beneficial ownership and on tax avoidance.

The case involves whether a UK resident company should have withheld tax on interest payments made to a Guernsey incorporated company. The UK company was the parent company of a property investment group of UK resident companies that invested in immoveable property in the UK. The group was financed by loans from directors of the group, founder family members, Gibraltar-resident trusts set up by the founders and the group's funded unapproved retirement benefit scheme.

Withholding tax avoidance

Tax advice was obtained to enable the group to continue deduct interest expense on the loans without the lenders being taxed on the payments they received. Success of the plan depended in part on a domestic law exemption from the borrower's obligation to withhold tax on the interest payments which turned on who was "beneficially entitled" to the interest payment

The plan involved changes to the loan terms followed by the lenders repeatedly assigning their creditor's rights third parties shortly before the loans were repaid and the original lenders then re-advancing loans. The First-tier Tribunal found that there was no commercial purpose to the refinancing structure itself other than the tax advantage.

Meaning of "beneficially entitled"

After reviewing the law on both of beneficial ownership and the related expression "beneficially entitled" in UK domestic tax law and the English decision in *Indofood International Finance v JP Morgan Chase Bank* ([2006] EWCA Civ 158 on Indonesia's treaties with Mauritius and the Netherlands, the court made a number of observations on the meaning of these terms.

- Although not strictly a term of art, the concept of beneficial ownership is well established. In essence, it means ownership for the benefit of the person in question.
- There is a significant degree of overlap between beneficial ownership and equitable ownership (a

feature of common law systems). However, the concepts are not entirely co-extensive. One reason is that the concept of beneficial ownership needs to be capable of operating in legal systems that do not have the same legal traditions, including Scotland, which adopts civil law ownership concepts.

- The fact that the concept of beneficial ownership is well established does not mean that the usual approach to statutory construction is to be ignored. Legislation must be construed purposively to ascertain whether it was intended to apply to the transaction, viewed realistically.
- A legal owner of property will not be its beneficial owner if they do not in fact have any of the benefits of ownership, such that they hold only a "mere legal shell. This is consistent with the fundamental requirement of ownership for the benefit of the person in question, or "ownership with benefits".
- It is possible for a legal property owner not to possess, or to lose, beneficial ownership without it vesting anywhere else.
- "Beneficial entitlement" should be construed with regard to the authorities that consider the concept of beneficial ownership. In broad terms, therefore, it can be construed as "entitlement with benefits". If the person in question would, in truth, have none of the benefits that entitlement would ordinarily bring, they will not be beneficially entitled.
- Nonetheless, the Court of Appeal declined to interpret beneficial entitlement in accordance with the approach taken by the Court of Appeal in *Indofood* on the basis that domestic tax law was involved and not an "international fiscal meaning" adopted in *Indofood*.

In applying these principles to the case, the Court concluded that the Guernsey company was not beneficially entitled to the interest as a result of the transactions. It could not use the funds received for any other purpose of the transactions or benefit from them in any other manner. If did not appear to derive any meaningful margin or other profit from its participation in the arrangements. Its involvement was entirely ephemeral, being confined to successive assignments of interest very shortly before the loans in question were repaid. There is no suggestion that it was either at risk as to the amount that might be paid, such that it might not be put in funds to pay for the assignment to it, or that it might be able to benefit from the receipt being higher than anticipated. It appeared that its obligation to pay for the loan participations assigned to it was entirely dependent on, and co-extensive with, the receipt of the interest.

Tax treaty implications

Although the court expressly declined to apply *Indofood*, the only UK decision on beneficial ownership in treaties (albeit on treaties that the UK is not a party to), the decision will inform on treaty interpretation.

First, the facts of the case are similar to those in *Husky Energy* where the plan was to reduce Canadian withholding tax. Legal ownership was for a very limited period of time and accompanied by a contractual obligation to pay away the same amount. Second, the reasoning of the judge Lady Justice Sarah Falk, an experienced tax practitioner, is not dissimilar to that of the Tax Court of Canada judge, John Owen, also experienced tax practitioner: the legal owner's participation in Hargreaves was described as "ephemeral"; in *Husky Energy*, the arrangement was described as "transitory" and the legal owner "enjoyed nothing more than temporary custodianship" of the payments received.

Second, although not cited by either court, the decisions are consistent with e.g. paragraph 12.4 of the OECD Commentary to Article 10 of the Model Treaty which refers to "that recipient's right to

use and enjoy the dividend is constrained by a contractual or legal obligation to pass on the payment received to another person."

Third, the similarity between beneficial ownership and beneficially entitled raises the question whether beneficial ownership in Article 10, 11 and 12 of tax treaties should be interpreted by reference to the domestic meaning by application of Article 3(2). The German Bundesfinanzhof has adopted this approach in its *judgement of 2 February 2022, I R 22/20*, ECLI:DE:BFH:2022:U.020222.IR22.20.0 where it applied article 39(2) of the Federal Fical Codeto give the treaty meaning of the term. That article attributes ownership to a person other than the legal owner who exercises effective control over an asset in such a way as to economically exclude the owner from affecting the asset during the normal period of its useful life..

Beneficial ownership and tax avoidance

The Court of Appeal applied the so-called *Ramsay Principle* of statutory interpretation. That requires legislation to be construed purposively to ascertain whether it was intended to apply to the transaction, viewed realistically (See *Barclays Mercantile Business Finance v Mawson* [2004] UKHL 51, paragraphs 32 and 36).

The court ruled that Parliament did not intend that the exemption should extend to a company in the position of the Guernsey company, which was involved on an ephemeral basis by way of steps that were entirely tax-motivated, and which did not benefit in any real sense from the interest that it paid away. That company's involvement not only had no commercial purpose but had no practical or real effect. This approach seems to have added little to the decision.

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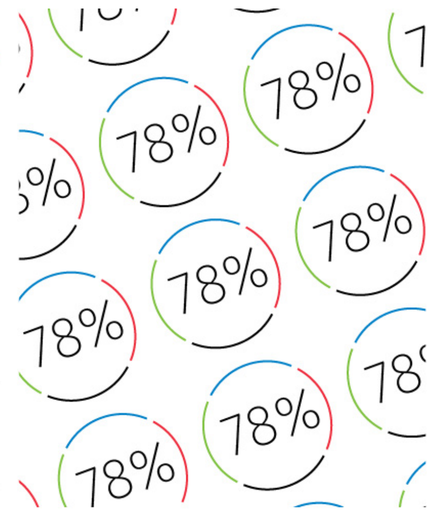

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