HIGH COURT OF JUSTICE (CHANCERY DIVISION)—21, 22, 23, 24 AND 25 MAY AND 5 AND 6 JUNE 1990

COURT OF APPEAL—1, 2, 3 AND 22 MAY 1991

J. Sainsbury PLC *v.* O'Connor (H.M. Inspector of Taxes)([1])

Corporation tax—Losses—Group relief—Company owning 75 per cent. of share capital of subsidiary but options existing in respect of 5 per cent.—Whether company beneficial owner of 75 per cent. of shares—Income and Corporation Taxes Act 1970, *s* 258, *Finance Act* 1973, *s* 28 *and Sch* 12, *para* 5.

Pursuant to a ten-year (renewable) joint venture agreement made on 4 October 1979 between S and GB, the ordinary share capital of H was owned as to 75 per cent. by S and 25 per cent. by GB. GB's minority interest was protected by provisions which included a term that neither party was to charge or dispose of its shareholding without the consent of the other, and a term that payment of dividends required the unanimous approval of all the directors.

The original intention had been a 70 per cent./30 per cent. split but, as that would have prevented S from qualifying for group relief in respect of anticipated trading losses of H during the first 4 or 5 years, the 75 per cent./25 per cent. split was established and by a second agreement made on the same day, S and GB granted to each other call and put options, exercisable after 5 years, in respect of 5 per cent. of the shares, the price being the amount paid up by S on the shares plus interest at a specified rate but minus the gross amount of any dividends previously paid on those shares. Neither option was exercised and by deed of 9 August 1985 the option agreement was terminated.

S appealed against the Inspector of Taxes' refusal of claims for group relief in respect of accounting periods from 12 January 1981 to 21 March 1987. The Special Commissioners dismissing the appeal in respect of losses incurred up to August 1985, held (i) that, notwithstanding the option agreement and the restrictions attached to its shareholding by the main agreement, S was the beneficial owner of a 75 per cent. holding in H within s 258 Income and Corporation Taxes Act 1970 but (ii) the option agreement was an arrangement" within para 5 Sch 12 Finance Act 1973 so that S failed to satisfy the additional requirements for group relief imposed by s 28 of that Act. S appealed.

The Chancery Division, allowing S's appeal, held that:

([1]) Reported (ChD) [1990] STC 516; (CA) [1991] 1 WLR 963; [1991] STC 318.

A (1) S was the beneficial owner of 75 per cent. of the shares in H because:—

(a) an unfettered freedom of disposition is not an essential feature of beneficial ownership;

B (b) beneficial ownership has nothing to do with control and is therefore unaffected by restrictions on a right to cause dividends to be declared, as distinct from a right to the beneficial receipt of any dividends which are declared;

(c) even if beneficial ownership of shares necessarily involves the right
C to reap the benefit of any increase (and the risk of suffering loss from any diminution) in the value of the shares, there is no requirement that their value must be capable of fluctuation or must reflect the changing profitability or value of the company; and

(d) while from a commercial point of view the simultaneous creation of
D both put and call options put the parties in much the same position as an unconditional contract of sale would do, in law the two situations are distinct; S's ownership carried full rights of beneficial enjoyment of both capital and income, defeasible by the exercise of the option; the effect on beneficial ownership of an option, whether at a fixed price or at market value at the date of exercise, is conditional on its exercise.

E

Wood Preservation Ltd. v. *Prior* 45 TC 112 considered.

(2) S did not fail to satisfy the additional requirements for group relief introduced by s 28 and Sch 12 Finance Act 1973. Paragraph 5 Sch 12 did not apply on the footing that the option agreement was an arrangement by virtue
F of which the equity holders entitlement to profits under profit distribution or to assets on the notional winding-up could be different as compared with his entitlement if effect were not given to the arrangements, because:—

(a) the option agreement was not an arrangement in respect of any of S's shares because para 5(3) applies only to arrangements which concern spe-
G cific and identifiable shares irrespective of their ownership for the time being;

(b) para 5(3) applies only whenever arrangements exist in respect of shares of such a nature that the equity holder could have a different entitlement in future while continuing to hold them; and

H (c) the assumption directed to be made by para 5(3)(a) is merely an assumption that, even if an arrangement is not legally binding, nevertheless it would be carried into effect according to its terms, but there was no finding that there was any arrangement or understanding, as opposed to a common expectation, that, once H had begun to trade profitably, one or other option would be exercised.

I

The Crown appealed.

Held, in the Court of Appeal, dismissing the Crown's appeal:—

(1) The nature and extent of the rights retained by S in relation to the 5 per cent. of the shares were such that those rights were more than "a mere

legal shell"; the restrictions, prior to 12 November 1984, on S's rights to dispose of those shares and to payment of a dividend upon them applied also to the remaining 70 per cent., and the fact that the amount of any dividend would have been deducted from the option price did not mean that S would not have been beneficially entitled to those dividends in the meantime. Where legal ownership was more than "a mere shell", the inference cannot be drawn, as a matter of construction, that Parliament did not intend to confer the advantages of group relief. A B

Wood Preservation Ltd. v. *Prior* 45 TC 112 distinguished.

(2) Paragraph 5(3) Sch 12 Finance Act 1973 is concerned solely with arrangements which could affect the rights attaching to shares, or a class of shares, and not with arrangements which affect the ownership of shares. C

CASE D

Stated under the Taxes Management Act 1970, s 56 by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. On 6–10 November 1989, I, one of the Special Commissioners, heard the appeals of J. Sainsbury PLC ("Sainsburys") against refusals by H.M. Inspector of Taxes of claims to group relief under s 258 Income and Corporation Taxes Act 1970 in respect of the losses of a subsidiary company, Homebase Ltd., for the following eight accounting periods: E

12 January 1981	–	28 February 1981 F
1 March 1981	–	27 February 1982
28 February 1982	–	26 February 1983
27 February 1983	–	26 March 1983
27 March 1983	–	24 March 1984
25 March 1984	–	23 March 1985 G
24 March 1985	–	22 March 1986
23 March 1986	–	21 March 1987

It was common ground before me that the claim in respect of the last period should be allowed. H

2. At all material times, 75 per cent. of the issued ordinary share capital of Homebase Ltd. was held by Sainsburys. The remaining 25 per cent. was held by a Dutch company, a subsidiary of GB-INNO-BM S.A., ("GB") which is a Belgian company. By an agreement ("the principal agreement") dated 4 October 1979 between Sainsburys and GB, the parties thereto agreed to set up and manage the business of Homebase Ltd. as a joint venture. By a further agreement ("the option agreement") of the same date, Sainsburys granted to GB an option to purchase, and GB granted to Sainsburys an option to require GB to purchase, 5 per cent. of the issued share capital of Homebase Ltd. Neither option was exercisable before the fifth anniversary of the incorporation of Homebase Ltd. (that is to say, in events, not before 12 November 1984). Neither option was ever exercised; and by a deed dated I

A 9 August 1985 the rights of both parties under the option agreement were formally terminated.

3. Four issues were in contention before me:

(i) Whether, notwithstanding the option agreement and the incidents B attached to its shareholding by the principal agreement, Sainsburys was the "beneficial owner" of the whole of its 75 per cent. holding in Homebase Ltd. as required by the provisions of the Income and Corporation Taxes Act 1970 relating to group relief;

(ii) Whether the options under the option agreement were "arrangements" C for the purposes of para 5(3) of Sch 12 to the Finance Act 1973; if so

(iii) Whether the Crown is entitled to rely on such "arrangements" (which, if implemented, would have reduced Sainsburys' holding and so would have caused the requirements of s 28 of the Finance Act 1973 not to be met), in isolation from other "arrangements" (contained in the D principal agreement) under which Sainsburys' holding could have been increased; and

(iv) If (ii) and (iii) are answered affirmatively, whether the "arrangements" under the option agreement ceased to exist earlier than August 1985, namely on 3 May 1984.

E

4. Oral evidence (principally in connection with issue (iv) above) was given by M. Jacques Dopchie (vice-president and managing director of GB) and Mr. Gurth Christian Hoyer Millar (a director of Sainsburys and chairman of Homebase Ltd.).

F 5. Three volumes of agreed documents were placed before me: bundle A (in two volumes) containing the history of the agreements between Sainsburys and GB, and bundle B containing correspondence etc. relating to the claims under appeal. Many of the documents contained in these volumes were not referred to during the hearing; but those mentioned in my decision were contained therein. Copies of the documentary evidence are not annexed G hereto as exhibits, but all or any of it is available for inspection by the Court if required.

6. The facts and the contentions of the parties are set out in my written decision, issued on 7 December 1989. A copy thereof is attached hereto and forms part of this Case. As will be seen from my decision, for the reasons H therein stated I answered the questions in para 3 above as follows: (i) Yes, (ii) Yes, (iii) Yes, (iv) No. And I determined the appeals accordingly (substantially in favour of the Crown).

7. Immediately after the determination of the appeals Sainsburys declared to us its dissatisfaction therewith as being erroneous in point of law I and on 8 December 1989 required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970, s 56, which Case we have stated and I, the Commissioner who heard the appeals, do sign accordingly.

8. The question of law for the opinion of the Court is whether, in relation to each of the issues set out in para 3 above, my decision was erroneous.

B. O'Brien } Commissioner for the Special Purposes of the Income Tax Acts

Turnstile House
98 High Holborn
London WC1V 6LQ

14 February 1990

DECISION

These appeals are against refusals by the Inspector of claims to group relief in respect of losses surrendered by Homebase Ltd. ("Homebase") to its principal parent company J. Sainsbury PLC ("Sainsburys"), the well-known retailer of food and provisions. Eight consecutive accounting periods are involved, commencing with Homebase's short first period ended 28 February 1981. However, as will appear, the problem which has given rise to the refusals of the claims was eliminated before the beginning of the eighth accounting period (the year to 22 March 1987) and the appeal in respect of that year must accordingly be allowed in any event. The aggregate amount of the claims remaining at stake is of the order of £25m.

Homebase's other parent company is GB-INNO-BM S.A., ("GB"), a Belgian company. GB owns an important chain of supermarkets in Belgium; and in 1970 it began to open, in association with its stores, premises devoted to the sale of "do-it-yourself" and home improvement goods, and garden centres. This venture (the so-called "Brico Centres") proved very successful, and GB has since exported the format to several other countries in Europe. It has done this by forming associations with foreign companies and taking substantial minority holdings in the joint venture companies thereby formed. Its know-how constitutes a major element of its input into such new companies. By 1978 GB already had such interests in both Holland and Germany.

In 1978 GB entered into negotiations with a company in the UK with a view to obtaining a similar interest in this country. However, GB's vice-president and managing director, M. Jacques Dopchie, was well-acquainted with the chairman of Sainsburys—then Mr. J.D., but soon afterwards Sir John, Sainsbury. (In order to avoid any risk of confusion of persons, I shall continue to refer to the chairman as "Sir John", his style during the remainder of the material years.) M. Dopchie's preference was for Sainsburys as a potential "partner" in the UK, and at his invitation Sir John visited three Brico Centres in October 1978. Sir John and M. Dopchie had a further discussion in March 1979. Following a further visit of inspection by Sainsbury personnel, the parties moved steadily towards an agreement. There was a meeting in London on 30 May attended by (among others) Sir John and M. Bienfait (GB's finance director), following which there was an unminuted discussion over lunch which included the question of the two companies' respective contributions to the proposed joint venture company; and it appears from a paper dated 15 June prepared by Sir John for the Sainsburys' board that those proportions had by then settled at 70 per cent. (Sainsburys) and 30 per cent. (GB).

Those proportions appeared in the draft heads of agreement (20 July) and survived several re-drafts of a joint venture agreement. On 16 August, however, a deputy chairman of Sainsburys wrote to M. Bienfait to say that Sainsburys had been advised that, with a 70:30 split, Sainsburys would not be entitled to claim group relief in respect of the (tax) losses which the new company was expected to incur. A few days later M. Bienfait was sent a memorandum which set out three possible ways of overcoming the problem: (i) change the proportions to 75:25 (on that basis Sainsburys could claim group relief); (ii) retain the 70:30 split, but arrange for GB's 30 per cent. to be held by a UK subsidiary (so that corresponding consortium relief would be available); (iii) run the new business as a partnership between Sainsburys and GB, sharing profits and losses on a 70:30 basis.

The third option appears to have commended itself to neither party. The second was not acceptable to GB, which wanted its share to be held through a Dutch subsidiary. The first option was acceptable, subject to an additional factor (suggested, it is believed, by GB's London solicitors)—put and take options, exercisable after (say) five years, over part of Sainsburys' equity holding extending to 5 per cent. of the issued capital.

In the event, the "75:25 + option" arrangement was adopted. It is the existence of the option which has given rise to the problems in this case.

The joint venture agreement ("the principal agreement") was executed on 4 October 1979. By clause 1 the parties agreed to incorporate a new English private limited company with an authorised share capital of £2m to which they (or companies appointed by them) would subscribe in the proportions 75 per cent. (Sainsburys) and 25 per cent. (GB). In events, GB's shares were taken up by a Dutch subsidiary, Eufidis bv. By clause 2.2 the provisions of the principal agreement were, if necessary, to prevail over the memorandum and articles of association of the new company.

By clause 6 the parties agreed to provide necessary finance (which in the context must have meant finance beyond the initial share subscriptions) in the proportions 70 per cent. (Sainsburys) and 30 per cent. (GB). In events that was not strictly adhered to. Between 1981 and 1984 there were no fewer than 9 issues of shares beyond the initial 2m authorised capital, all on a 75:25 basis; and it was only in 1983 that the new company began to receive loan capital from its parents on a 70:30 basis. In October 1984 the total share capital amounted to 28m and the loan capital to 24m. Clause 6 also stated that it was not intended that the new company should pay dividends during its first four years.

Clause 7 provided that neither side should charge or dispose of its shareholding without the consent of the other. (The clause does not refer in terms to "any part" of a shareholding.)

Clause 8 dealt with the composition of the new company's board. Sainsburys were entitled to appoint 5 directors; and GB, 4. At least one director from each side had to be present at every meeting. If the Sainsbury directors were unanimous, their (or his) voice was to prevail, save in respect of "reserved matters". The chairman of the board was to be a Sainsbury appointee (clause 9).

Clause 11 set out the "reserved matters" which required the unanimous approval of all the directors. They covered changes in the memorandum and articles; the appointment of the general manager; major financial commitments; the approval of budgets; real property matters; the payment of dividends; and matters in which a director, or one of the parent companies, might have a conflict of interest. A

B

Clause 14 provided that the parties would exercise their voting rights to procure that the new company was managed and operated in accordance with the provisions of the principal agreement. It would not seem consistent with that provision that Sainsburys should be able to use its majority position to put the new company into liquidation during the term of the principal agreement. C

Clause 17 provided that the principal agreement should continue for 10 years' with automatic renewal for successive 3-year periods in the absence of prior notice given by either party. There were provisions in this and other clauses for premature determination of the principal agreement in certain events (for example, a material change in the ownership of either of the parties). No matter how termination might come about, provision was made for Sainsburys to acquire, on that event, the whole of the GB shareholding. (Provision was made in respect of the price to be paid.) D

Clause 18 gave GB a put option exercisable during the second half of the primary 10-year term of the principal agreement: the right to require Sainsburys to purchase the whole of the GB shareholding on (broadly) a net asset value basis. E

The other clauses of the principal agreement do not, I think, contain material helpful to the resolution of the questions before me. F

On the same day, 4 October 1979, but by a separate document, ("the option agreement") Sainsburys and GB granted to each other call and put options (respectively) over 5 per cent. of the shares in the new company, in issue at the date of exercise. The options were not exercisable before the fifth anniversary of the new company's incorporation (in events, therefore, not before 12 November 1984). G

On the exercise of either option the price payable by GB for the additional shares was the amount paid up thereon (by Sainsburys)

> "as increased by interest at the rate of 1 per cent. above the base lending rate from time to time of National Westminster Bank Ltd. such interest to be calculated on the amount for the time being paid up on such shares compounded annually and to be in respect of the period up until exercise of either of the said options and as decreased by the gross amount of any dividend paid during such period on the shares the subject of the said options." H I

The interest rate referred to was, I understand, the rate at which Sainsburys was accustomed to borrow from its bankers. As counsel for the Crown, Mr. Andrew Park Q.C., pointed out, the effect of the price formula was that Sainsburys would, on the exercise of either of the options, simply recover the entirety of the net financing cost to itself of acquiring the shares in question, on the footing that it had borrowed the subscription moneys from the bank.

The new company was incorporated on 12 November 1979 under the name Sainsbury-GB (Home Improvements) Ltd. It changed its name to Homebase Ltd. early in 1981, when it commenced trading. The chairman of its directors has, from the beginning, been Mr. G.C. Hoyer Millar (who is, and has at all material times been also a member of Sainsburys' main board). M. Bienfait is one of the GB directors of Homebase.

I turn now to the first of the questions before me. The primary section granting group relief was, during the years in question, s 258, Income and Corporation Taxes Act 1970. Subsections (1) and (5)(a), coupled with subss (1)(b) and (3) of s 532 (definitions) require Sainsburys to show that it was the "beneficial owner" of 75 per cent. (or more) of the ordinary share capital of Homebase.

That requirement is, on the face of the principal agreement and the ordinary shares actually in issue, clearly fulfilled. The Crown, however, argues that it is not, because of the existence (and, in the event of an exercise thereof, of the effect) of the options under the option agreement, and also because of restrictions on the normal enjoyment of shares contained in the principal agreement.

A normal incident of beneficial ownership of shares is that the owner reaps the benefit of increases in value (and, correspondingly, suffers reverses). But, Mr. Park argued, as a result of the terms of the options in the option agreement the position was that GB knew that it would in due course be able to pick up the benefit of any increase in value which had accrued in respect of 5 per cent. of the shares (and Sainsburys knew that it could recover the initial cost of 5 per cent. if the joint venture failed). If either option were exercised, the cost of the 5 per cent. investment would seem ultimately to fall on GB.

As to the restrictions contained in the principal agreement, Mr. Park pointed not only to clause 7 (no charges or alienations without consent) but also to the "reserved matters" which included, in particular, the payment of dividends. Quite apart from the fact that the principal agreement envisaged no dividends for four years, Sainsburys could not use its majority position thereafter to ensure that dividends were paid—and any dividend received by it in respect of the shares the subject of the option rights simply reduced the price which it would receive for those shares on the exercise of the option. Indeed, Mr Park suggested, the terms of the principal agreement are such that the voting rights attached to Sainsburys' holding were of very limited practical significance.

Putting all the facts of the case together (including the circumstances in which the 5 per cent. option came into being), it is the Crown's contention that the position in relation to those shares was the same, for the purpose of judging "beneficial ownership" for s 258 purposes, as if there had been not an option but an unconditional contract of sale. In the latter connection Mr. Park cited *Wood Preservation Ltd.* v. *Prior*(1) 45 TC 112 and *Ayerst* v.

(1) [1969] 1 WLR 1077.

C. & K. (Construction) Ltd.[1] 50 TC 651 (income tax cases relating to loss A
relief) and a number of stamp duty cases relating to relief on transfers
between associated companies, *viz*: *Parway Estates Ltd.* v. *Commissioners of*
Inland Revenue 45 TC 135; *Leigh Spinners Ltd.* v. *Commissioners of Inland*
Revenue 46 TC 425; *Holmleigh (Holdings) Ltd.* v. *Commissioners of Inland*
Revenue 46 TC 435; *Brooklands Selangor Holdings Ltd.* v. *Commissioners of*
Inland Revenue [1970] 1 WLR 429: and *Commissioners of Inland Revenue* v. B
Ufitec Group Ltd. [1977] STC 363. Mr. Park also referred me to pages
368–370 of Sergeant and Sims on Stamp Duties (9th Edition), and in partic-
ular to the first complete paragraph on page 370.

Mr. Peter Whiteman Q.C., who appeared for Sainsburys, did not accept
that any of the stamp duty cases was of authority in the present context. I do C
not agree. The "beneficial owner" test is used in a number of different tax
contexts, some relief being made available where there is (as Lord Donovan
put it in *Wood Preservation*) "... a substantial measure of identity between
... two companies". The purpose is common to the several contexts. But it
remains to be seen whether the cases cited to me are, in the light of their
facts, of direct assistance to the Crown. D

What the authorities clearly show is that a registered holder of shares
loses (or, in appropriate circumstances, may not even acquire) beneficial
ownership for the purpose of statutory provisions of this sort if another per-
son acquires (or has) such beneficial rights, enforceable (directly or indi- E
rectly) against the registered holder, that the latter's legal title is precarious
(or ephemeral). But the situation falls to be considered from the registered
holder's standpoint, and too nice an examination of the other person's rights
is not called for. In this context "beneficial ownership" and the possession of
an "equitable interest" are not synonymous. Indeed, there is one recognised
situation in which a corporate registered holder loses beneficial ownership F
without there being, strictly "another person" at all—beneficial ownership
simply goes into suspense on the holder's liquidation.

The question then arises as to whether the authorities merely provide
illustrations or whether they also constitute something in the nature of a lim-
iting test. In *Wood Preservation* the Court of Appeal was evidently anxious G
not to be taken as defining the scope of "beneficial ownership"; and it seems
to me that Lord Donovan was prepared to approach the matter on a some-
what broad basis.

But in *Brooklands Selangor*, Pennycuick J. laid more emphasis on the
existence of an immediately binding unconditional contract. In that case the H
facts (greatly simplified for present purposes) were that the majority holder
and the minority holders of the shares in a company, BSR, decided to parti-
tion the company's assets. The scheme involved the taking of a number of
preliminary steps including (i) the formation of a new company (Holdings) as
a wholly-owned subsidiary of BSR; (ii)) an increase in Holdings' capital to
enable it in due course to purchase the assets appropriated to the minority I
shareholders by issuing shares to the latter; and (iii) a reduction in BSR's
capital, to eliminate the minority shareholders' interest in that company. The
arrangement was conditional on those steps (which involved obtaining the
sanction of the Court) being taken : and was to become unconditional on the

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[1] [1976] AC 167.

delivery of the Court Order for registration at the Companies Registry. That happened on 29 December 1966 when all the preliminaries were complete; and the necessary steps to give effect to the scheme then took place. They included, in particular, the transfer by BSR of its (original) shares in Holdings. The question for decision was whether, at the time of that transfer, BSR was still the "beneficial owner" of Holdings (those shares being, at the time, the only Holdings shares actually issued). Pennycuick J. held that it was not, because on 29 December 1966 BSR had come under a binding obligation to make the transfer in accordance with the scheme arrangements. That was sufficient to decide the matter, but Pennycuick J. expressed himself as having no doubt that BSR was the "beneficial owner" of the Holdings shares right up to 29 December 1966, albeit subject to conditional obligations. It appears not to have mattered that the only step remaining to be taken to render the obligations unconditional was of a purely formal nature. There was no suggestion that that step might not be taken.

In my judgment the grant of an option (and *a fortiori* the grant of an option which is not presently exercisable) does not affect "beneficial ownership" of the subject-matter. I accept that in the present case the economics of the situation were such that there was initially a strong likelihood that one or other of the options under the option agreement would, in due course, be exercised. But the effect of an option on the ownership of the subject-matter is conditional on its actual exercise. I find it impossible to say that GB was the "beneficial owner" of any part of Sainsburys' holding : and I know of no authority for the proposition that beneficial ownership can be said to be in suspense, outside that special class of case into which the present does not fall.

Mr. Park's argument as regards "beneficial ownership" did not however rest on the option alone. He relied also on the cumulative effect of the terms of the principal agreement. I do not think it can be denied that by those terms Sainsburys can hardly be said to have enjoyed what would normally be regarded as the ordinary incidents of beneficial ownership of its majority shareholding. But special considerations arise where a business is run as a joint venture, whether the parties technically constitute a consortium or not. Certainly the concept of "beneficial ownership" cannot be so narrow as to cause the sort of provisions naturally found in consortium arrangements to affect claims to relief. But the real problem with this part of Mr. Park's argument is, it seems to me, that it amounts to a contention that Sainsburys (and, for that matter, GB also) was not the beneficial owner of any part of its holding in Homebase. That cannot be right.

In my opinion, therefore, Sainsburys satisfies the "beneficial owner" test in relation to its 75 per cent. holding in Homebase.

The second question is whether Sainsburys can show that the additional conditions introduced by the Finance Act 1973, s 28(2) are satisfied: namely, that it

> "... is beneficially entitled to not less than 75 per cent ... of any profits available for distribution to equity holders of [Homebase]; and ... would be beneficially entitled to not less than 75 per cent. ... of any assets of [Homebase] available for distribution to its equity holders on a winding-up."

It is thus not sufficient that a parent company should hold the right number of shares: the economic position must be duly reflected in the holding.

Part I of Sch 12 to the 1973 Act contains the necessary definitions and rules for special cases in giving effect to s 28. As a holder of ordinary shares in Homebase, Sainsburys was a relevant "equity holder". Paragraphs 2 and 3 of the Schedule contain wholly unsurprising statements of what is meant by "profits available for distribution to equity holders" or "assets available (etc.)", as the case may be. They alone are sufficient for cases exhibiting no special factors. Paragraph 4 deals with the special case where the dividend or winding-up rights attached to some (at least) of the shares counting as equity shares are subject to a ceiling of some sort; and it provides that if, as a result, the shareholder's percentage of receipts would be less than it would otherwise have been on a para 2 or para 3 basis, then the lower percentage is the one relevant for judging whether the 75 per cent. condition in s 28 is satisfied.

Paragraph 5 is the one with which I am directly concerned. Very broadly, it deals with the case where although there is nothing special about the situation in the accounting period for which the claim to relief is made, something will or may happen in a later accounting period; and it provides (again broadly) that the current situation is to be treated as being no better than the future situation (or possible future situation). That again may reduce the percentage used for judging whether the s 28 condition is satisfied.

It is necessary for me to set much of para 5 out in order to enable the parties' contentions to be followed.

> "5.—(1) This paragraph applies if, at any time in the relevant accounting period, any of the equity holders—
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> (*a*) to whom the profit distribution is made, or
>
> (*b*) who is entitled to participate in the notional winding-up,
>
> holds, as such an equity holder, any shares or securities which carry rights in respect of dividend or interest or assets on a winding-up which are of such a nature (as, for example, if any shares will cease to carry a right to a dividend at a future time) that if the profit distribution or the notional winding-up were to take place in a different accounting period the percentage to which, in accordance with the preceding provisions of this Part of this Schedule, that equity holder would be entitled of profits on the profit distribution or of assets on the notional winding-up would be different from the percentage determined in the relevant accounting period.
>
> (2) Where this paragraph applies, there shall be determined—[the percentage of (*a*) profits and (*b*) assets to which the claimant company] would be entitled if the rights of the equity holders in the relevant accounting period were the same as they would be in the different accounting period referred to in sub-paragraph (1) above.
>
> (3) If in the relevant accounting period an equity holder holds, as such, any shares or securities in respect of which arrangements exist by virtue of which, in that or any subsequent accounting period, the equity holder's entitlement to profits on the profit distribution or to assets on the notional winding-up could be different as compared with his entitle-

ment if effect were not given to the arrangements, then for the purposes of this paragraph

(*a*) it shall be assumed that effect would be given to those arrangements in a later accounting period, and

(*b*) those shares or securities shall be treated as though any variation in the equity holder's entitlement to profits or assets resulting from giving effect to the arrangements were the result of the operation of such rights attaching to the shares or securities as are referred to in sub-paragraph (1) above."

Paragraph 5 does not contain within itself a statement of what is to be done with the percentages determined under its sub-para (2). But its sub-para (4) refers one back to the corresponding provisions in para 4; and they direct a comparison with the percentages which (had there been no special factors) would have been those arrived at under paras 2 and 3. And if the para 5(2) percentages are less than the para 2/3 percentages, the former are the percentages relevant for judging whether the s 28 condition is satisfied.

For the sake of completeness I add that the final sub-paragraph of para 5 covers a case where the relevant percentage for s 28 purposes is affected by both para 4 and para 5.

The essential question on para 5, so far as the present case is concerned, is whether, in the context of s 28 and this related paragraph, the word "arrangements" in sub-para (3) is apt to include arrangements (*viz.*, the options contained in the option agreement) by virtue of which shares might cease to belong to the relevant equity holder (Sainsburys) altogether.

Mr. Whiteman answered that question in the negative.

His first line of argument concerned the relationship between s 28 and s 29 of the 1973 Act. Together, they constitute a "counter-abuse" code; but severally they are designed to cover different mischiefs. Section 28 and the related Part I of Sch 12 deal with cases where shares have special incidents; s 29 deals with cases where rights may be lost through alienation. Put or take options over shares are plainly "arrangements" relevant to the purpose of s 29; but they have no place in s 28's Schedule. Mr. Whiteman also relied on the fact that s 29 identifies as "mischievous" not possible alienations *simpliciter*, but alienations having specified effects; and it should not be supposed, he contended, that group relief should be barred under s 28's Schedule by reason of a possible alienation which did not have such effects. On the Crown's argument, a case plainly within s 29(1)(b)(i) would *a fortiori* be within s 28 (by way of para 5(3) of the Schedule) as well.

Mr, Whiteman also made a number of points on the construction of para 5 itself:

(i) The opening words "This paragraph applies" indicate that the case-content of the entire paragraph (including in particular sub-para (3)) is informed by the evident case-content of sub-para (1). The paragraph is, of course, not concerned only with cases which fall literally within sub-para (1), but any additional cases must still fall within the principle of that sub-paragraph, namely that a variation of rights is involved. Sub-paragraph (1) accordingly covers actual provisions in the company's articles affecting rights attached to shares; and the "arrange- A ments" referred to in sub-para (3) are any other agreements *to the same effect.* Arrangements having any other effect are outside para 5.

(ii) The scheme of the paragraph involves the making of a comparison between the situation in the year of claim and that in some later accounting period. (That much is common ground.) Mr. Whiteman con- B tended that, in order to make such a comparison, the claimant company must be an "equity holder" then as well as now. In that connection he referred to para 5(2).

(iii) Since, in making such a comparison, one is seeking to identify a variation in rights, one must be looking at the *same* shares at the two periods. This followed from the use of the words "any shares" and C "those shares" in sub-para (3). Furthermore, if "arrangements" in sub-para (3) included possible alienations of shares, the receivables not only "could" be different : they would necessarily be so.

Lastly, on this part of the case, Mr. Whiteman contended that if the options in the option agreement were (contrary to his previous argument) D "arrangements" within para 5, so too were a number of provisions contained in the principal agreement by virtue of which Sainsburys might have become the sole holder of Homebase—GB's put option under clause 18 being the most outstanding example. It was necessary to consider the situation as a whole, and it was not open to the Crown to pick out and rely on one "arrangement" out of the full arrangements between the parties. E

Mr. Park accepted that s 28 and 29 of the 1973 Act were "counter-abuse" provisions: but contended that there was no reason to suppose that they were in the fullest sense mutually exclusive. On the contrary, a degree of overlapping on particular facts should cause no surprise. Within s 29 there clearly is room for overlapping between the case described in (i) and (ii) in F subs (1)(b). The existence of s 29 (where "arrangements" do comprehend agreements relating to transfers of shares) does not therefore help to demonstrate that "arrangements" in s 28's Schedule cannot include such agreements.

Mr. Park did not accept that the Crown's view of "arrangements" in G para 5(3) rendered s 29(1)(b)(i) wholly redundant—successor companies feature in the latter, but not in the former. Further, in this connection, he referred to the clear misdescription of the effect of s 29 contained in para 8(1) of Sch 12: from which it is fair to infer that s 29 (as enacted) is not in the form in which it was originally conceived along with s 28. That makes it rather difficult to rely on words now appearing in s 29 as a guide to the H meaning of s 28 and its Schedule.

It is significant, Mr. Park argued, that "arrangements in para 5(3) are not in terms limited to arrangements relating to rights. The sub-paragraph looks directly at the potential effect of the arrangement on the quantum of receivables. A variation of rights by "arrangement", may have such an effect, I and so be within the sub-paragraph; but a transfer of shares also brings about an effect on receipts. Sub-paragraph (3) has therefore a case-content potentially wider than that of sub-para (1).

But for the hypothesis at the end of sub-para (3), that would be a difficult proposition to maintain, in the light of the opening words ("This *para-*

graph applies ...") in sub-para (1), on which Mr. Whiteman relied. Mr. Park contended however, that Mr. Whiteman had gravely underestimated the effect of those hypotheses, and especially that contained in (b). The effect of hypothesis (b) in a case where the "arrangement" relates to a disposition of shares is, Mr. Park argued, this: that the variation in the shareholder's entitlement to receipts following an arranged disposition is treated as having flowed, not from such disposition, but from a notional state of affairs, namely that the shares had carried variable rights. In short, the situation is, by the hypotheses, rendered indistinguishable from that in the illustration contained in sub-para (1). Once the statutory conversion has been effected, any difficulties there might otherwise be in comparing present and future receivables disappear.

Mr. Park took issue with Mr. Whiteman on the latter's final argument on this part of the case, namely that the Crown could not select one "arrangement" from the totality of the arrangements between the parties. The arrangement constituted by the option agreement was quite separate, and could operate independently of (for example) clause 18.

In my judgment the Crown's arguments on the Sch 12 issue are to be preferred.

Although ss 28 and 29 of the Finance Act 1973 share a common general objective, they set about its attainment from two distinct standpoints. Section 28 is designed to ensure that group relief is not available between two companies whose connecting link is not based on a real, stable, (and heavily predominant) economic interest. Section 29, on the other hand, is concerned with a different aspect, that of control by one company of another (or of its trade). Voting control is a condition laid down in the principal group relief section (s 258, ICTA 1970): what s 29 adds is a stability requirement option in favour of a third party affecting the shares of one of the companies seems to me to be something capable of being relevant from either point of view. There is no ground for presupposing that such options are outside the scope of s 28 (and its Schedule), merely because they are obviously within the purview of s 29.

"Arrangements" in para 5(3) of Sch 12 (as in s 29) means "arrangements of any kind, whether in writing or not" (s 32(6)). Options such as those in the option agreement are obviously arrangements as so defined. I accept that Mr. Whiteman seeks to limit not the "kind", but the subject-matter of the arrangements relevant for para 5(3) purposes. But what his argument does not explain is why Parliament (or, in the first place, the draftsman) thought sub-para (3) necessary, along with its hypotheses. If it be true that the subject-matter of the sub-para (3) "arrangements" goes no further than the essential case-content of sub-para (1), both formal and informal "variation of rights", cases would have been covered by the simple expedient of casting sub-para (1) in terms of "arrangements". (Indeed, s 29 does precisely that.) I therefore accept Mr. Park's contention that sub-para (3) is free-standing, so far as its subject-matter is concerned; that the hypotheses are there in order artificially to fit the case-content of sub-para (3) into sub-para (1) for mechanical reasons (in much the same way as sub-para (4) makes use of provisions in para 4). I must say, it is easier to admire than to like this style of drafting—even in a Schedule.

Mr. Whiteman's final argument, that all the arrangements between the parties have to be considered as a whole, is, in my view and on such facts as are here present, a non-starter. Of course, if one arrangement modifies another, or if one cannot be given effect to without bringing another into operation, the combined effect must be looked to. But the options under the option agreement constitute discrete arrangements. The existence of (for example) clause 18 of the principal agreement has no bearing on the matter. The question is, were there any arrangements which might produce the effect which the statute is designed to counter? In my opinion there were.

The third and last issue in dispute is the date on which the bar to group relief ceased to be effective. By a deed dated 9 August 1985, the rights of Sainsburys and GB under the option agreement were terminated "with effect from the date hereof": and the Crown's contention is that that deed provides the answer. (That is why the appeal relating to the accounting period commencing 23 March 1986 must be allowed on any footing.)

But Sainsburys contends for 3 May 1984: and that calls for findings of further facts.

It was the practice of the Homebase partners to hold periodic "summit meetings", attended only by Sir John and Mr. Hoyer Millar (for Sainsburys) and Baron Vaxelaire and M. Dopchie (GB's president and vice-president). The discussions were informal and wide-ranging and in the absence of a secretary, no formal minutes were taken.

At such a meeting held on 10 June 1983 Sir John expressed the view that experience had shown that a 75:25 per cent. split probably reflected the parties' respective contributions more accurately than 70:30 per cent. would do; and he asked GB to consider its option under the option agreement in the light of that. Baron Vaxelaire and M. Dopchie did not appear unsympathetic to Sir John's argument but it was agreed to defer the matter to a later occasion.

In February 1984 M Dopchie suggested that "the 5 per cent. issue" be discussed at the forthcoming 1984 summit meeting. That the suggestion should have come from him may seem surprising: the truth is that M. Dopchie had something else in mind as well.

As earlier stated, the principal agreement could be terminated by Sainsburys after 10 years (i.e. in 1989), and Sainsburys could then call on GB to sell to it GB's entire shareholding in Homebase. The profitability of the joint venture to GB depended on the continuance of its interest in the venture for a number of years after the start-up costs had been met out of profits. In 1979 it was thought that a 10-year minimum total period would suffice, on the footing that the initial expense would be covered in about three years. However, GB had not reckoned with the exceptionally high cost of land and building in the United Kingdom (or with Sainsburys' requirement of high standards), and it became evident that the initial costs would not be covered so quickly. The duration of the principal agreement was accordingly a cause of anxiety to M. Dopchie; and he saw in Sir John's wish to eliminate GB's 5 per cent. option an opportunity of trading that option for an extension beyond 1989 of the term certain of the agreement. In M. Dopchie's mind, the latter was the more important thing.

The 1984 summit meeting was held on 3 May. I make my findings as to what transpired thereat principally from the following evidence: (i) the oral evidence of M. Dopchie and Mr. Hoyer Millar; (ii) an exchange of letters (10 May and 30 May 1984) between Sir John and Baron Vaxelaire (together with a further letter from Sir John to Baron Vaxelaire of 14 June 1984); (iii) a note of the meeting (in French) made by M. Dopchie on 9 May 1984, for his own files, together with a subsequent translation thereof prepared (by Sainsbury's company secretary, I believe) for Mr. Hoyer Millar; and (iv) a much later letter (1 August 1985) from M. Dopchie to Sir John. I should add that I have disregarded two letters from M. Bienfait to Mr. Hoyer Millar (18 April and 29 June 1984) on the ground that his thinking was obviously quite out of line with that of those who attended the meeting.

The oral evidence did not add substantially to the near-contemporary documentary evidence. But I did find helpful an answer given by Mr. Hoyer Millar to a question put to him by myself: both for what he said, and for what he did not say. I asked him whether he would have been shocked if GB had exercised its option when it became exercisable later in the year. He replied that he would have been amazed; and he added that it would have been "...a very stupid thing for them to have done". It might well have put in question Sainsburys' acceptance of the proposition (expressed at the meeting and confirmed in the exchange of letters) that the relationship between the parties should continue beyond 1989. What Mr, Hoyer Millar did *not* say is that GB *could* not have exercised its option.

I am wholly satisfied that the option agreement was not contractually varied or terminated. Indeed, Mr. Whiteman did not suggest that it was. I find that there emerged at the meeting a clear understanding that the Homebase operation would remain a joint venture for at least five years beyond 1989, but it was appreciated that the principal agreement would probably require some up-dating. Consideration of such adjustments could be deferred until about 1988. The question whether a "5 per cent. option" should be a feature of the post-1989 arrangements would be one of the matters then to be considered. Implicit in that was an understanding that GB's 5 per cent. option under the option agreement would not be exercised in the meanwhile: if it were, there could be nothing to discuss at a later date.

In my opinion that mutual understanding in relation to GB's 5 per cent. option was an "arrangement"; and, moreover, was an arrangement which at the very least qualified the "arrangement" constituted by the option agreement in such a way that the latter had thereafter to be viewed in the light of the former. The fact that one was a formal agreement and the other only a "gentlemen's agreement" is immaterial: the defect, from the point of view of claiming group relief, depends simply on the existence of "arrangements", irrespective of their status.

That however leaves unanswered the question of the extent of the qualification of the option agreement effected by the understanding. Did the understanding bring GB's right to an end, or did it postpone (for an indefinite period) the date upon which its right would become exercisable?

Upon the evidence (and in particular the near-contemporary evidence) I find that the latter is the better view. I accept that the practical distinction between "termination" and "suspension *sine die*" is slender, and I do not regard it as at all unreasonable that M. Dopchie should have later written that "the option was effectively abandoned" by GB. But on analysis the degree of "abandonment" was inadequate: it left the option in its then existing unexercisable state. The situation immediately after 3 May 1984 was essentially no different (and therefore, from the group relief point of view, no better) than it had been before.

There is, perhaps, an additional point. At the 1984 meeting, *Sainsburys'* option under the option agreement was in nobody's mind. That was because it was common ground that that had been "effectively abandoned" by Sainsburys at least a year earlier. Mr. Park did not mention Sainsburys' option, but I would, I think, have great difficulty in accepting the proposition that a unilateral decision by an option-holder not to avail himself of his right to exercise it because it would not be advantageous to do so, was an "arrangement" for present purposes. I suspect that the parties never attached much importance to the existence of that option, if only because the obvious circumstances in which Sainsburys might have wanted to exercise it were the same as those which would induce GB to rely on clause 18—namely, failure of the venture. Nevertheless, Sainsburys' option was, strictly, as much of a bar to relief as GB's; and the option agreement seems to have remained unqualified quoad that option until the option agreement itself was dealt with in August 1985. (In terms of "arrangements", I think the precise date might be 2 August when Sir John accepted M. Dopchie's proposal to cancel the option agreement, rather than 9 August, the date of the deed.)

For those reasons I conclude that the claims for the six accounting periods up to 23 March 1985 fail *in toto*; that the claim for the next period (which included the cessation of the option arrangements) also fails, at any rate so far as it relates to losses referable to the period prior to such cessation; and the claim for the last period before me succeeds (subject to quantification).

B. O'Brien } Commissioner for the Special Purposes of the Income Tax Acts

Turnstile House
98 High Holborn
London WC1V 6LQ

7 December 1989

The case was heard in the Chancery Division before Millett J. on 21, 22, 23, 24 and 25 May and 5 June 1990 when judgment was reserved. On 6 June 1990 judgment was given against the Crown, with costs.

Peter Whiteman Q.C. and *Brian Green* for the Company.

Andrew Park Q.C. and *Alan Moses Q.C.* for the Crown.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Pilkington Bros. Ltd.* v. *Commissioners of*

A *Inland Revenue* 55 TC 705; [1982] 1 WLR 136; [1982] STC 103; *English Sewing Cotton Co. Ltd.* v. *Commissioners of Inland Revenue* [1947] 1 All ER 679; *Ayerst* v. *C. & K. (Construction) Ltd.* 50 TC 651; [1976] AC 167; *Conservative and Unionist Central Office* v. *Burrell* 55 TC 671; [1982] 1 WLR 522; *Franklin* v. *Commissioners of Inland Revenue* 15 TC 464; *Parway Estates Ltd.* v. *Commissioners of Inland Revenue* 45 TC 135; *Leigh Spinners Ltd.* v.
B *Commissioners of Inland Revenue* 46 TC 425; *Holmleigh (Holdings) Ltd.* v. *Commissioners of Inland Revenue* 46 TC 435; *Commissioner of Stamp Duties* v. *Livingston* [1965] AC 694; *Commissioners of Inland Revenue* v. *Ufitec Group Ltd.* [1977] STC 363; [1977] 3 All ER 924; *Floor* v. *Davis* 52 TC 609; [1980] AC 695.

C

Millett J.:—This is an appeal by the taxpayer J. Sainsbury PLC (which I shall call "Sainsburys") from the decision of a single Special Commissioner dated 7 December 1989 dismissing appeals against the refusal by H.M.
D Inspector of Taxes of Sainsburys' claims to group relief under s 258 of the Income and Corporation Taxes Act 1970 in respect of the trading losses of its subsidiary Homebase Ltd. (which I shall call "Homebase") for six accounting periods from 12 January 1981 to 23 March 1985 and in respect of so much of the losses in the next accounting period as were incurred before 9 August 1985.

E

The question is whether at any material time Homebase qualified as a "75 per cent. subsidiary" of Sainsburys within the meaning of the relevant statutory provisions. The facts are fully set out in the decision of the Special Commissioner, and can be stated shortly. At all material times Sainsburys was the registered shareholder in respect of 75 per cent. of the ordinary share
F capital of Homebase. The remaining 25 per cent. was registered in the name of a Dutch subsidiary of GB-INNO-BM S.A. (which I shall call "GB") a company incorporated in Belgium. Homebase was established by Sainsburys and GB as a joint venture governed by the terms of an agreement (which I shall call "the principal agreement") dated 4 October 1979 and entered into between them. This provided that the joint venture should continue for a
G period of ten years renewable for successive periods of three years with provision for earlier determination on the occurrence of certain specified events. On termination Sainsburys was to acquire GB's interest at a price which reflected the net asset value of Homebase as a going concern. During the second five years of the initial ten-year term GB had the right to require Sainsburys to purchase its interest on similar terms.

H

During the continuance of the principal agreement GB's minority interest was protected by the inclusion of provisions of a kind common in such agreements. Neither party was to charge or dispose of its shareholding without the consent of the other; the parties undertook to exercise their voting rights to procure that Homebase was managed and operated in accordance
I with the provisions of the principal agreement; and certain "reserved matters" required the unanimous approval of all the directors, including those appointed by GB. "Reserved matters" included changes to the memorandum and articles of association and the payment of dividends.

It was initially intended to set up Homebase as a 70 per cent.-30 per cent. joint venture. At a late stage in the negotiations, however, it was realised that this would prevent Sainsburys from qualifying for group relief in respect of the trading losses which Homebase was expected to incur during the first four or five years. To qualify, Sainsburys needed to be the beneficial owner of not less than 75 per cent. of the ordinary share capital of Homebase. GB was not content simply to accept a reduction of its interest to 25 per cent. The solution which was adopted was to establish Homebase as a 75 per cent.–25 per cent. joint venture and to arrange for the grant of put and call options over 5 per cent. of the shares so that they could be transferred to GB once the initial loss-making period was past and the availability of group relief for losses was no longer of any consequence.

Accordingly, on the same day, 4 October 1979, but by a separate document (which I shall call "the option agreement") Sainsburys and GB granted to each other call and put options respectively over 5 per cent. of the shares in Homebase in issue when the options were exercised. The options were not exerciseable before the fifth anniversary of the incorporation of Homebase, that is to say in the events which happened before 12 November 1984. On the exercise of either option the price payable by GB for the additional shares was not based on the value of Homebase at the date of the exercise of the option but was the amount paid upon the shares (by Sainsburys) increased by interest at a rate specified in the option agreement (which the Special Commissioner found represented the rate at which Sainsburys was accustomed to borrow from its bankers) and reduced by the gross amount of any dividends previously paid in respect of the shares. As counsel for the Crown, Mr. Park Q.C., pointed out, and subject to a slight mismatch (probably due to a drafting error), the price formula enabled GB, on the exercise of either option, to acquire 5 per cent. of the shares at their net financing cost to Sainsburys.

Neither option was ever exercised, an by a deed dated 9 August 1985 the rights of both parties under the option agreement were terminated "with effect from the date hereof". The Crown conceded that Sainsburys qualified for group relief in respect of losses incurred thereafter (or possibly after 2 August 1985, when the parties agreed in correspondence to enter into the deed). Sainsburys contended if necessary for a still earlier date, namely 3 May 1984, but its claim was rejected by the Special Commissioner on the facts.

The Crown has not alleged that the option agreement was a sham or that there was a private arrangement or understanding that one or other option would be exercised once it was safe to do so. The contractual documents must, therefore, be taken at their face value.

Two questions of law have been argued before me: (1) whether the Special Commissioner was correct in holding that, notwithstanding the option agreement and the restrictions attached to its shareholding by the principal agreement, Sainsburys was "the beneficial owner" of the whole of its 75 per cent. holding in Homebase as required by s 258 of the Income and Corporation Taxes Act 1970; and (2) whether the Special Commissioner was correct in holding that the option agreement was an "arrangement" of such a nature that para 5 of Sch 12 to the Finance Act 1973 had the effect of causing Sainsburys to fail to satisfy the additional requirements for group relief imposed by s 28(2) of that Act.

A 1. *"Beneficial Ownership".*

The leading authority on the meaning of "beneficial ownership" in this context is *Wood Preservation Ltd.* v. *Prior*[1] 45 TC 112. In that case the taxpayer had sold all the shares in its subsidiary, but the sale was conditional upon obtaining a letter from a third party. The taxpayer was obliged to use
B its best endeavours to obtain the letter, but the fulfilment of the condition was not within the control of either party. The contract provided that no dividends were to be paid on the shares pending completion of the sale. The Court of Appeal held that, pending fulfilment of the condition, the taxpayer was not "the beneficial owner" of the shares for the purpose of the statutory provisions relating to loss relief. It did not matter that the purchaser was not
C "the beneficial owner" either. It was sufficient that, for the moment at least, the taxpayer had parted with all legal right to the beneficial enjoyment of the shares and of any income to be derived therefrom. As Lord Donovan pointed out (at page 132[2]):

> "[The taxpayer] could not have disposed of the shares to anybody else: had it tried to do so it could have been restrained by injunction.
> D Second, it could not declare or pay any bonus or dividend on its shares: it had specifically precluded itself from doing so. Third, it would have been bound at any time actually to transfer the shares if [the purchaser] waived the condition in question—which in law, at any rate, it could have done at any time after the contract was signed. The shares (in a word) were like a tree which the owner could not sell and could not cut
> E down and of which he could enjoy none of the fruit."

He concluded that by the contract of sale the taxpayer:

> "... ceased to be able to appropriate to itself any of the benefits of ownership. This does not necessarily involve the consequence that [the
> F purchaser] became the beneficial owner while the condition remained operative."

Harman L.J. described "beneficial ownership" as meaning

> "... an ownership which is not merely the legal ownership by the
> G mere fact of being on the register but the right at least to some extent to deal with the property as your own."

In his view the taxpayer was not "the beneficial owner" because

> "... he has parted with every title, right and interest which he has, except the legal ownership which follows from the fact that he is the reg-
> H istered owner of the shares on the books. ... There was no benefit at all in their ownership: it was a mere legal shell."

The decision in that case led Pennycuick J. to observe in *Brooklands Selangor Holding Ltd.* v. *Inland Revenue Commissioners* [1970] 1 WLR 429, at page
I 450:

> "I would only add this, that considerable difficulties arise in this connection if one seeks to equate the expression 'beneficial owner' with the expression 'equitable owner' in the technical sense in which that term is used in equity law. ... I do not think, however, that equitable owner-

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(1) [1969] 1 WLR 1077. (1) *Ibid*, at pages 1095H–1096A.

> ship is to be thus equated for this purpose with beneficial ownership A
> although, no doubt, in many instances they may come to the same
> thing."

"Beneficial ownership" cannot, I apprehend, exist without equitable
ownership, but in the present context, it seems, it involves more than this. It
requires more than the ownership of an empty husk, bereft of those rights of B
beneficial enjoyment which normally attach to equitable ownership.
Mr. Park submitted that in the case of shares it involves: (i) the unfettered
right to dispose of the shares; (ii) the right to the beneficial enjoyment of any
dividends declared in respect of the shares; and (iii) the ability to reap the
benefit of any increase (and the risk of suffering loss from any diminution) in
the intrinsic value of the shares. These submissions call for further examina- C
tion.

(i) I do not accept that an unfettered freedom of disposition is an essen-
tial feature of beneficial ownership. A litigant subject to a Mareva injunction,
a party to a joint venture or shareholders' agreement, and the grantor not
only of an option but even of a mere right of pre-emption or first refusal, are D
all subject to limitations on their freedom of disposition; but so long as they
retain their rights to the beneficial enjoyment of the shares and of any
income derived therefrom while they remain undisposed of I cannot accept
that they are not beneficial owners. In *Wood Preservation Ltd.* v. *Prior* at
first instance Goff J. rejected the presence of a right to dispose of the shares
for the owner's benefit as the test of beneficial ownership, saying at page E
126(1):

> "Mr. Goulding ... submitted that the true test is: has the vendor
> been deprived of the right to dispose of his shares for his own benefit
> and has that right passed to the purchaser? ... I am satisfied that this is
> not a mere option case, but I do not think that that test is the right one, F
> because in the case of an option or a right of pre-emption the vendor
> does deprive himself of the right to deal with the property or his own
> benefit. It is true that he can assign the property subject to the option or
> right of pre-emption, but he cannot ignore it and take a better offer."

There is no suggestion in any of the judgments in the Court of Appeal G
that he was wrong in rejecting the test which had been proposed or in distin-
guishing the case before him from the case of an option and putting the case
of an option on the other side of the line. In my judgment, what prevented
the taxpayer in *Wood Preservation Ltd.* v. *Prior* from being the beneficial
owner of the shares pending fulfilment of the condition was not its inability
to dispose of them without committing a breach of contract but its inability H
to do so for its own benefit *because, subject only to the fulfilment of the con-
dition, it had already sold them.*

(ii) The right to the beneficial enjoyment of any dividends which may be
declared in respect of shares is certainly an important feature of beneficial
ownership, though it is not the only, or necessarily the most important, way I
in which the trading profits of a subsidiary can be enjoyed by its parent. But
the right to the beneficial receipt of any dividends which are declared must be
distinguished from the right to cause them to be declared: "beneficial owner-
ship" has nothing to do with control. Again, what prevented the taxpayer in

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(1) [1969] 1 WLR 1077, at pages 1090H/1091A.

Wood Preservation Ltd. v. *Prior* from being the beneficial owner of the shares pending fulfilment of the condition was not its inability to cause dividends to be declared, but its inability to do so for its own benefit because, subject only to the fulfilment of the condition, it had already sold the shares on which the dividends would otherwise be paid with effect from a date anterior to the payment.

(iii) I do not accept what lies behind Mr. Park's submission that the beneficial ownership of shares necessarily involves the hope of gain or the risk of loss. Even if it be granted that the beneficial ownership of shares necessarily involves the right to reap the benefit of any increase (and the risk of suffering loss from any diminution) in the value of the shares themselves, there is no requirement that their value must be capable of fluctuation or must reflect the changing profitability or value of the company. Any such requirement would substitute an economic test for a legal one and confuse the existence of legal rights with their value. "Beneficial ownership" has nothing to do with value or the economic attributes of ownership, as the need for the enactment of s 28 of the Finance Act 1973 demonstrates.

In submitting that Sainsburys was not the beneficial owner of more than 70 per cent. of the shares in Homebase, Mr. Park did not rely upon the provisions of the principal agreement standing alone. Absent the option agreement, he conceded that the restrictions contained in the principal agreement, which were mutual in any case, did not affect beneficial ownership. But, he said, so long as the option agreement remained in force, the restrictions on Sainsburys' rights performed a dual function: they protected GB's minority interest in the joint venture, and they provided a necessary underpinning to GB's call option. Were such restrictions not already to be found in the principal agreement, he submitted, they would have been included in the option agreement. For my part, I think that in such a case they would have been somewhat different and less restrictive; but in substance I accept the submission.

The Crown's case on "beneficial ownership", therefore, stands or falls by the presence of the option agreement, and in particular GB's call option. From a commercial point of view, of course, the simultaneous creation of both put and call options puts the parties in much the same position as an unconditional contract of sale would do; but in law the two situations are quite distinct. Mr. Park did not rely in this part of his argument on the presence of Sainsburys' put option; as he pointed out, this fortified Sainsburys' beneficial ownership rather than diminished it.

What, then, is the effect on beneficial ownership of a call option? An option is not a conditional contract but an irrevocable offer which is open to acceptance by the exercise of the option. In the meantime, the grantor is under a contractual obligation not to put it out of his power to do what he has offered to do; but subject thereto he retains not only equitable ownership but also all the rights of beneficial enjoyment normally attaching to equitable ownership. In the present case, Sainsburys had irrevocably offered to sell 5 per cent. of the shares in Homebase to GB; but, unlike the taxpayer in *Wood Preservation Ltd.* v. *Prior*, it had not, subject only to the fulfilment of an outstanding condition, already sold them. It could not have put Homebase into liquidation without GB's consent, but had Homebase been wound up before the exercise of either option, Sainsburys would have been entitled for its own benefit to 75 per cent. of the distributions to members. Likewise, Sainsburys could not have caused any dividends to be paid without

GB's consent, but if any dividends had been paid on the shares Sainsburys A
would have been entitled to receive them for its own benefit. Such dividends
would have been treated for tax purposes as franked income of Sainsburys;
that is to say, the advance corporation tax paid by Homebase thereon would
be treated as paid on account of Sainsburys' liability to tax. Sainsburys' beneficial entitlement to dividends is not affected by the fact that, if either
option should be exercised, the price receivable by Sainsburys would be B
reduced by the amount of any prior dividend. That affects the calculation of
the price, not the beneficial ownership of the dividend. Had the dividend
exceeded Sainsburys' financing costs, there was no mechanism for reducing
the price below zero.

Most importantly, however, at least from the commercial point of view, C
Sainsburys was entitled to include the net assets (and trading profits if any)
of Homebase in its consolidated group accounts subject only to a contra provision for a minority interest of 25 per cent. (not 30 per cent.). These considerations show that Sainsburys' equitable ownership was no empty husk, but
carried with it full rights of beneficial enjoyment of both capital and income,
defeasible by the exercise of the option. As the Special Commissioner perti- D
nently observed, "... the effect of an option on the ownership of the subject
matter is conditional on its actual exercise". In my judgment that is as true of
Sainsburys' beneficial ownership as it is of its equitable ownership. The two
marched together.

Although Mr. Park did not concede any of this, he did not seriously dis- E
pute it. He placed great reliance on the price formula for the acquisition of
the shares by GB. Whatever the value or profitability of Homebase at the
date when the option was exercised, he stressed, GB was entitled to acquire
the shares at their net cost to Sainsburys. Consequently, he said, it was GB
and not Sainsburys which had the hope of gain and the risk of loss; GB and
not Sainsburys which stood to reap the benefit or suffer the loss arising from F
any change in the underlying profitability or value of Homebase. I have
already dealt with this submission, which in my judgment introduces an irrelevant consideration for which there is no support in the decided cases. But
the submission fails for another reason also: it is true, *but only if the options
were exercised.* The existence of the call option meant that GB *could* obtain
the benefit of an increase in the value of Homebase, not that it would do so G
(and in the events which have happened it has not). Of course, that possibility alone would be sufficient to affect the value of the shares in the meantime, but it would not affect Sainsburys' rights in relation to the shares. In
my judgment, the effect on beneficial ownership of an option at a fixed price
is no different from that of an option at market value at the date of exercise.
In either case, its effect is conditional on its exercise. H

It is true that, even after the option agreement had been entered into,
the parties continued to refer to the joint venture as a 70 per cent.–30 per
cent. venture. That is understandable but, in my judgment, inaccurate. In law
it was a 75 per cent.–25 per cent. joint venture, and would correctly be
reflected as such in its accounting treatment. The effect of the option agree- I
ment was to give GB the right to convert it into a 70 per cent.–30 per cent.
joint venture for the future but on terms which would involve it in no greater
expense than if it had been a 70 per cent.–30 per cent. joint venture from the
outset. That was, no doubt, an "arrangement" by virtue of which Sainsburys
could have ceased to be the beneficial owner of not less than 75 per cent. of
the shares in Homebase, but that is not enough for s 258. When Parliament

came to legislate for such a case (by s 29(1)(b)(i) of the Finance Act 1973) it carefully limited the operation of the section to the case where the subsidiary would not only cease to be a member of its original group but would thereupon become a member of a different group.

Accordingly, in my judgment the Special Commissioner was correct in holding that at all material times Sainsburys was the beneficial owner of not less than 75 per cent. of the shares in Homebase.

2. Schedule 12 to the Finance Act 1973.

Prior to 1973 it was a simple matter to satisfy the requirements of s 258 while at the same time stripping the 75 per cent. shareholding of its normal rights. This could be achieved by the creation of two or more classes of shares in the subsidiary, and issuing one class (representing not less than 75 per cent. of the ordinary share capital but carrying the right to less than 75 per cent. of the dividends and assets available on a winding-up) to the company intending to claim group relief, and the other class or classes (representing 25 per cent. or less of the ordinary share capital but carrying the right to more than 25 per cent. of the dividends and assets available on a winding-up) to others. More sophisticated variations of such arrangements could be found. They succeeded because the beneficial ownership of shares involves the right to the beneficial enjoyment of whatever rights may be attached thereto, but does not require those rights to be commercially significant or commensurate with the holding.

This was not acceptable to Parliament, and accordingly s 28(2) of the Finance Act 1973 imposed two additional requirements for group relief; namely, (a) that the taxpayer should be beneficially entitled to not less than 75 per cent. of any profits available for distribution to equity holders of the subsidiary company, and (b) that the taxpayer should be beneficially entitled to not less than 75 per cent. of the assets of the subsidiary company available for distribution to its equity holders on a winding-up. Section 28(5) provided that Part I of Sch 12 to the Act "... shall have effect for supplementing this section". It is the Crown's case that, so long as the option agreement was in force, para 5 of that Schedule had the effect of causing Sainsburys to fail to satisfy the additional requirements for group relief introduced by s 28(2).

This is an unpromising argument, for the shares in Homebase carried no special rights to dividends or distributions on a winding-up; Sainsburys' beneficial entitlement to not less than 75 per cent. of the profits available for distribution as dividends and of the assets available on a winding-up was co-extensive with its beneficial ownership of the shares themselves; and the Schedule has effect only for the purpose of supplementing the additional requirements of s 28(2), not the original requirement under s 258. However, the argument commended itself to the Special Commissioner, and I must examine it in some detail.

Schedule 12 is extremely complicated. Mr. Park helpfully summarised its provisions by saying that, in order to qualify for group relief, they require the taxpayer to be entitled (i) to not less than 75 per cent. of the dividends or distributions on a notional winding-up no matter how large such dividends or distributions might be and (ii) to not less than 75 per cent. of the dividends or distributions on a notional winding-up no matter when such dividends or distributions might occur. This latter requirement covers the case

where the shares carry normal rights to dividends and distributions on a A
winding-up during the first few years when losses are expected to be incurred, but lesser or no rights to dividends and distributions on a winding-up thereafter. In this latter case, however, there is a further refinement: group relief is denied not only where the rights initially attached to the shares *would* cause the entitlement to dividends and distributions on a winding-up to alter, but also where arrangements exist in respect of the shares by virtue of which such B
entitlement *could* alter. The Crown submits that the present case is within this last category.

The structure of the Schedule is as follows. Paragraph I contains general definitions. For present purposes it is sufficient to record the part of the definition of "an equity holder" which is "... any person who ... holds ordi- C
nary shares in the company". Paragraph 2 defines "the profit distribution" and otherwise supplements s 28(2)(a) (entitlement to dividends); and para 3 performs a similar function in relation to s 28(2)(b) (entitlement to distributions, on a winding-up). Paragraphs 4 and 5 are the operative paragraphs. Paragraph 4 introduces the requirement that the taxpayer should be entitled to not less than 75 per cent. of the dividends or distributions on a winding-up D
no matter how large the dividend or distribution, and para 5 the requirement that the taxpayer should be similarly entitled no matter when the dividend or the distribution on a winding-up should occur.

Paragraph 5(1) is as follows:

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> "This paragraph applies if, at any time in the relevant accounting period, and of the equity holders (*a*) to whom the profit distribution is made, or (*b*) who is entitled to participate in the notional winding-up, holds, as such an equity holder, any shares or securities which carry rights in respect of dividend or interest or assets on a winding-up which are of such a nature (as, for example, if any shares will cease to carry a F
> right to a dividend at a future time) that if the profit distribution or the notional winding-up were to take place in a different accounting period the percentage to which, in accordance with the preceding provisions of this Part of this Schedule, that equity holder would be entitled of profits on the profit distribution or of assets on the notional winding-up would be different from the percentage determined in the relevant accounting G
> period."

It is to be observed that that paragraph as it stands has no application to the present case for at least two reasons. In the first place, none of Sainsburys' shares (not even 5 per cent.) carried rights of the nature specified. And in the second place, even if the parties' rights under the option agree- H
ment are deemed to be attached to the shares themselves, there was no certainty that either option would ever be exercised, and therefore no certainty that Sainsburys' entitlement in a future accounting period *would* (as opposed to *could*) be different from that in the relevant accounting period.

The Crown, however, relies on para 5(1) read in the light of the assump- I
tions required to be made by para 5(3). That sub-paragraph is as follows:

> "If in the relevant accounting period an equity holder holds, as such, any shares or securities in respect of which arrangements exist by virtue of which, in that or any subsequent accounting period, the equity holder's entitlement to profits on the profit distribution or to assets on the notional winding-up could be different as compared with his entitle-

> ment if effect were not given to the arrangements, then for the purposes of this paragraph (*a*) it shall be assumed that effect would be given to those arrangements in a later accounting period, and (*b*) those shares or securities shall be treated as though any variation in the equity holder's entitlement to profits or assets resulting from giving effect to the arrangements were the result of the operation of such rights attaching to the shares or securities as are referred to in sub-paragraph (1) above.

That sub-paragraph would apply, for example, where the taxpayer held shares in respect of which there was an arrangement that at some future date the memorandum of association would be amended to alter the dividend and other rights attaching to the shares, or in respect of which there was an arrangement that the taxpayer would waive all or part of its entitlement to dividends upon them. The former would need assumption (a) to bring it within para 5(1); the latter would also need the deeming provision in para (b) (which for brevity, though at the expense of strict accuracy, I shall call an assumption) to do so.

Mr. Park's submissions on the application of para 5(3) to the circumstances of the present case were as follows:

1. The option agreement was "an arrangement" in respect of all Sainsburys' in Homebase (or possibly in respect of 5 per cent. thereof—it does not matter which).

2. If either option was exercised (thereby giving effect to the option agreement) Sainsburys' entitlement to dividends and distributions on a winding-up would be different from what it would be if the options were not exercised.

3. Consequently, the option agreement was an arrangement in respect of shares held by Sainsburys "... by virtue of which [its] entitlement to profits in a subsequent accounting period could be different as compared with [its] entitlement if effect were not given to the arrangements".

4. Accordingly, the condition for the application of para 5(3) is satisfied and the two assumptions directed by that paragraph must be made for the purposes of para 5(1).

5. It must therefore be assumed that effect would be given to the option agreement (i.e., it must be assumed that one or other option would be exercised); and the variation in Sainsburys' entitlement to dividends or distributions on a winding-up resulting from the exercise of the option must be treated as though it were the result of the operation of rights attaching to the shares.

6. Given those assumptions, para 5(1) applies, with the result (as was conceded to follow) that while the arrangement continued to subsist Sainsburys did not satisfy the additional requirements for group relief introduced by s 28(2).

In my judgment, that argument breaks down in three places.

(1) *"Arrangements ... in respect of shares"*. It was conceded that the option agreement was an arrangement", but in my judgment it was not an

arrangement "in respect of" any of Sainsburys' shares. GB's call option did not necessarily even affect Sainsburys' shares. This can be tested by supposing that with Sainsburys' consent, GB transferred a 10 per cent. shareholding in Homebase to a third party while retaining the benefit of the option agreement. On the exercise of the call option by GB, Sainsburys would not necessarily be obliged to reduce its shareholding below 75 per cent.; it could satisfy its obligation to transfer 5 per cent. of the shares to GB by acquiring them from the third party. This shows that the obligation was not "in respect of" any particular shares. Mr. Park was not disposed to dispute this. He submitted that, whatever might be the position in other circumstances, the option agreement was an arrangement "in respect of" Sainsburys' shares so long as Sainsburys and the option-holder were the only shareholders. But I do not accept that the nature of the arrangement can be affected by the circumstance that in practice it can be performed in only one way, or that its nature can be changed when circumstances change.

Nor do I accept that it is correct to equate an arrangement which merely affects the ownership of shares with an arrangement "in respect of" the shares themselves. Those words are of crucial importance to the operation of para 5(3): "If ... an equity holder holds ... any shares or securities in respect of which arrangements exist ... (*b*) *those* shares or securities shall be treated ...". The importance of identification of the shares "in respect of which" the arrangements exist show that the arrangements must concern specific and identifiable shares themselves irrespective of their ownership for the time being. The language of para 5(3) is to be contrasted with that of s 29(1)(b), where the words "in respect of shares" are omitted. In my view, this is deliberate, for the arrangements in question in para 5(3) are much narrower than those in s 29. Unlike s 29, which is concerned with alienation, para 5 is concerned with shares which either carry special rights or in respect of which arrangements exist so that they should be treated as carrying special rights. In my judgment, neither the call nor the put option constituted an arrangement of such a nature.

(2) *"The equity holder"*. In the second place, I do not accept that the opening words of para 5(3) are satisfied. This turns on the identity of "the equity holder" and the meaning of the words "the equity holder's entitlement". Mr. Whiteman, who appeared for Sainsburys, posed the question:

> "Are the various references to 'the equity holder' in para 5(3) references to the same person; or are they references to the person for the time being holding the relevant shares that is to say the shares 'in respect of which' the arrangements exist?"

In my judgment, this is not a true alternative, for the answer is "both"; para 5 is concerned with special rights attached, or to be treated as attached, to shares, and not with alienation. The ambiguity inherent in the defined term "equity holder" is brought out by substituting the statutory definition, so that para 5(3) reads:

> "If in the relevant accounting period a (person who holds ordinary shares in the company) holds, as such, any shares or securities in respect of which arrangements exist by virtue of which ... the entitlement of the (person who holds ordinary shares as aforesaid)", and so on.

Does this latter phrase mean the same person, regardless of whether he would continue to hold the ordinary shares in question (or any ordinary

A shares, for that matter, for the arrangements might require the transfer of his entire holding)? Or does it mean "the person who holds those shares, whoever he may be?" In my judgment, the answer is neither; it means "the said person being the holder of the said shares".

B I reach that conclusion for five reasons:

(1) Schedule 12 only has effect for the limited purpose of supplementing the additional requirements introduced by s 28(2), not the original requirement of beneficial ownership contained in s 258. The whole of the rest of the
C Schedule is concerned with special rights attached to particular shares, and with actual or potential variations in such rights, and not with changes in beneficial ownership. If possible, para 5(3) should be similarly construed.

(2) The assumption on which the Schedule is predicated is that a com-
D parison can be made between the entitlement of the equity holder on two separate occasions, but that his identity and the shares he holds are the same. If possible, para 5(3) should be similarly construed.

(3) "Equity holder" is defined as "... a person who holds ordinary
E shares in the company". There is no justification for treating this as including a person who presently holds ordinary shares in the company but who would no longer do so at the time predicated for the notional payment of dividends or distribution on a winding-up.

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(4) Where para 5(3) applies, the shares in respect of which the arrangements exist are to be treated as if the equity holder's changed entitlement were the result of the operation of rights attached to the shares. This, and the constant reference to shares in respect of which the arrangements exist, strongly support the conclusion that the equity holder's changed entitlement arises notwithstanding his continued-holding of the shares.

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(5) Paragraph 5(3) has effect only through the operation of para 5(1). Paragraph 5(1) is concerned solely with the rights attached to the shares and with changes in the rights of the holder in respect of the shares while he continues to hold them. It applies when the same shareholder ("that equity
H holder") would in a future accounting period have a different entitlement while continuing to hold the shares (and so continuing to be "the equity holder" in respect of them). Paragraph 5(3) should be similarly construed so as to apply whenever arrangements exist in respect of shares of such a nature that the equity holder could have a different entitlement in future while continuing to hold them.

I

My conclusions on these two matters, which I have necessarily dealt with separately, reinforce each other. They lead to the conclusion that the option agreement was not an arrangement of the kind described in the opening words of para 5(3), so that the assumptions directed by that subparagraph do not have to be made.

3. *"Give effect to the arrangements".*

I do not accept that the assumption directed to be made by para 5(3)(a) sufficient to bring para 5(1) into operation. That turns on the meaning of the words "give effect to the arrangements". Mr. Park submitted that to give effect to arrangements by virtue of which certain consequences could follow means to give them such effect that those consequences would follow; and he equated the words with "exercise the options". I do not accept that. Assumption (a) could easily have been so worded. Instead, the only assumption required to be made is an assumption that effect would be given to the arrangement. An arrangement may or may not be legally binding, and if not legally binding effect may or may not be given to it. An assumption that effect would be given to it is in my judgment merely an assumption that even if not legally binding nevertheless it would be carried into effect according to its terms. That requires the arrangement to be identified. In the present case there is no finding that there was any arrangement or understanding that, once Homebase had begun to trade profitably, one or other option would be exercised. There was, no doubt, a common expectation that that would happen, but there has not been found to have been any arrangement or understanding to that effect. The only arrangement that existed, and therefore the only assumption required to be made, was that, if either option were exercised, Sainsburys would transfer a 5 per cent. shareholding to GB. That is not enough to bring para 5(1) into operation. In the absence of an arrangement, and therefore an assumption, that one or other of the options would be exercised, there would still be no certainty that Sainsburys' entitlement *would* (as opposed to could) be different.

3. *Conclusion.* I conclude, therefore, that at all material times Sainsburys was entitled to group relief, as well during the period when the option agreement was in force as after it. That makes it unnecessary to deal with Sainsburys' alternative claim that the option agreement was effectively abandoned on 3 May 1984 so that no arrangements existed thereafter. I would not, however, have acceded to this submission. The conclusion of the Special Commissioner rested on his findings of primary facts with which this Court cannot interfere. My conclusion that the option agreement was not a bar to the obtaining of group relief also makes it unnecessary to decide whether it was legally discharged on 2 or 9 August 1985, and I express no opinion on it. I allow the appeal.

Appeal allowed, with costs.

The Crown's appeal was heard in the Court of Appeal (Lloyd, Nourse and Ralph Gibson L.JJ.) on 1, 2 and 3 May 1991 when judgment was reserved. On 22 May 1991 judgment was given unanimously against the Crown, with costs.

Andrew Park Q.C. and *Launcelot Henderson* for the Crown.

Peter Whiteman Q.C. and *Brian Green* for the Company.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Leigh Spinners Ltd.* v. *Commissioners of Inland Revenue* 46 TC 425; *Holmleigh Holdings Ltd.* v. *Commissioners of Inland Revenue* 46 TC 435; *Commissioners of Inland Revenue* v. *Ufitec Group Ltd.*

[1977] STC 363; *Commissioner of Stamp Duties (Queensland)* v. *Livingston* [1965] AC 694; *re Munster* [1920] 1 Ch 268; *Bank voor Handel en Sheepvart N.V.* v. *Administrator of Hungarian Property* [1954] AC 584; *Conservative & Unionist Central Office* v. *Burrell* 55 TC 671; [1982] 1 WLR 522; *Franklin* v. *Commissioners of Inland Revenue* 15 TC 464; *Vandervell* v. *Commissioners of Inland Revenue* 43 TC 519; [1967] 2 AC 291; *Griffith* v. *Pelton* [1958] Ch 205; *Spiro* v. *Glencrown Properties Ltd.* [1991] 1 All ER 600; *Booth* v. *Ellard* 53 TC 393; [1980] 1 WLR 1443; *Pilkington Brothers Ltd.* v. *Commissioners of Inland Revenue* 55 TC 705; [1982] 1 WLR 136.

Lloyd L.J.:—The question in this case is whether the taxpayer, J. Sainsbury PLC, can claim group relief under s 258 of the Income and Corporation Taxes Act 1970 in respect of trading losses of its subsidiary Homebase Ltd. during the period 12 January 1981 to 9 August 1985.

In October 1978 Sainsburys entered into negotiations with a Belgian company GB-INNO-BM for setting up a joint venture company in the United Kingdom. The purpose was to develop a chain of home-improvement stores, with or without associated garden centres. The initial intention was that the shares should be held in the proportion 70 per cent. Sainsburys: 30 per cent. GB. But in August 1979 it was realised (it is perhaps surprising that it was not realised before) that Sainsburys would not be able to take advantage of the group relief provisions unless the new company were a 75 per cent. subsidiary. So the solution which the parties reached as as follows. By a principal agreement dated 4 October 1979, ("the joint venture agreement") Sainsburys agreed to subscribe 75 per cent. of the share capital in the joint company, and GB 25 per cent. By a separate option agreement of the same date, Sainsburys granted GB an option to purchase 5 per cent. of the share capital, ("the call option"), and GB granted Sainsburys an option to require GB to purchase 5 per cent. of the share capital ("the put option"). These options were not to be exercised within five years of the incorporation of the new company. In the event neither option was exercised, and the option agreement was cancelled by deed dated 9 August 1985. It is not suggested that the agreements were a sham.

Two questions arise. The first is whether Sainsburys were "the beneficial owner" of the whole of its 75 per cent. holding for the purpose of s 258 of the 1970 Act, notwithstanding GB's option to purchase 5 per cent. of the share capital after five years. The second question is whether, if Sainsburys would otherwise have been entitled to claim the benefit of group relief, the option agreement was an "arrangement" within the meaning of para 5(3) of Sch 12 of the Finance Act 1973. If so, Sainsburys would lose the benefit of group relief, by virtue of s 28 of the 1973 Act. The Special Commissioner answered the first question in favour of the taxpayer, and the second question in favour of the Crown. On appeal, by way of Case Stated, Millett J. answered both questions in favour of the taxpayer.

I find myself in complete agreement with the Judge, not only with his conclusion, but also (subject to one minor point) with his reasons; so much so, that I would be content simply to adopt his judgment as my own. But as there is always the possibility of this case going higher, I must spell out my own reasons for dismissing the appeal.

Statutory Framework A

I start by setting out for convenience the statutory provisions relevant to both questions.

I start with the 1970 Act. Section 258 provides: B

"(1) Relief for trading losses ... may in accordance with the following provisions of this Chapter be surrendered by a company (called 'the surrendering company') which is a member of a group of companies and, on the making of a claim by another company (called 'the claimant company') which is a member of the same group, may be allowed to the
claimant company by way of a relief from corporation tax called 'group C
relief'.

...

(5) For the purpose of this section ...

(*a*) two companies shall be deemed to be members of a group of D
companies if one is the 75 per cent. subsidiary of the other or both are 75 per cent. subsidiaries of a third company,

(*b*) ..."

Section 532 provides:

"(1) For the purposes of the Tax Acts a body corporate shall be E
deemed to be—

(*a*) ...

(*b*) A '75 per cent. subsidiary' of another body corporate if and so long as not less than 75 per cent. of its ordinary share capital is owned F
directly or indirectly by that other body corporate,

(*c*) ...

(3) In this section references to ownership shall be construed as references to beneficial ownership."

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Sections 28 and 29 of the 1973 Act are "anti avoidance" provisions. Section 28(2) provides;

"Nothwithstanding that at any time a company (in this subsection referred to as 'the subsidiary company') is a 75 per cent. subsidiary ... within the meaning of section 532 of the Taxes Act, of another company
(in this subsection referred to as 'the parent company') it shall not be H
treated at that time as such a subsidiary for the purposes of the enactments relating to group relief unless, additionally, at that time—

(*a*) the parent company is beneficially entitled to not less than 75 per cent. ... of any profits available for distribution to equity holders of the subsidiary company; and
I

(*b*) the parent company would be beneficially entitled to not less than 75 per cent. ... of any assets of the subsidiary company available for distribution to its equity holders on a winding-up."

Thus the broad effect of s 28 is that it is not enough for group relief that the parent company is beneficial owner of 75 per cent. of the ordinary share capital of its subsidiary; it must also be beneficially entitled to 75 per cent. of the dividends, and 75 per cent. of the assets on winding up.

Section 28(5) gives effect to Part 1 of Sch 12 of the Act.

Section 29 applies to an arrangement whereby a company may cease to be a member of one group, and becomes a member of another group. Where such an arrangement is in existence, the company is treated as not being a member of the first group.

Schedule 12 is simple in concept, but complicated in detail. I shall refer to the relevant companies as parent and subsidiary, and for the sake of clarity I shall omit all reference to assets on a winding-up. The provisions relevant to the entitlement to dividends are as follows:

> "1(1) For the purposes of section 28 of this Act and this Schedule, an equity holder of a company is any person who—
>
> (*a*) holds ordinary shares in the company ...
>
> 2(1) Subject to the following provisions of this Part of this Schedule, for the purposes of section 28 of this Act, the percentage to which one company is beneficially entitled of any profits available for distribution to the equity holders of another company means the percentage to which the first company would be so entitled in the relevant accounting period on a distribution in money to those equity holders of—
>
> (*a*) an amount of profits equal to the total profits of the other company which arise in that accounting period (whether or not any of those profits are in fact distributed), or
>
> (*b*) if there are no profits of the other company in that accounting period, profits of £100,
>
> and in the following provisions of this Part of this Schedule, that distribution is referred to as 'the profit distribution'.
>
> ...
>
> 4(1) This paragraph applies if any of the equity holders—
>
> (*a*) to whom the profit distribution is made ...
>
> holds, as such an equity holder, any shares or securities which carry rights in respect of dividend or interest ... which are wholly or partly limited by reference to a specified amount or amounts (whether the limitation takes the form of the capital by reference to which a distribution is calculated or operates by reference to an amount of profits or assets or otherwise).
>
> (2) Where this paragraph applies, there shall be determined—
>
> (*a*) the percentage of profits to which, on the profit distribution, the first company referred to in paragraph 2(1) above would be entitled ...
>
> if, to the extent that they are limited as mentioned in sub-paragraph (1) above, the rights of every equity holder falling within that sub-paragraph (including the first company concerned if it is such an equity holder) had been waived.

(3) If, on the profit distribution, the percentage of profits determined as mentioned in sub-paragraph (2)(*a*) above is less than the percentage of profits determined under paragraph 2(1) above without regard to that sub-paragraph, the lesser percentage shall be taken for the purposes of section 28 of this Act to be the percentage of profits to which, on the profit distribution, the first company referred to in paragraph 2(1) above would be entitled as mentioned in that paragraph."

Thus if there is a class of shares carrying limited rights, such rights are deemed to be waived to the extent that they are so limited. If, as a result, the parent company's dividend, as a percentage of the whole, is less than it would have been without the waiver, the lesser percentage is taken for the purpose of s 28.

Paragraph 5 provides:

"(1) This paragraph applies if, at any time in the relevant accounting period, any of the equity holders—

(*a*) to whom the profit distribution is made ...

holds, as such an equity holder, any shares ... which carry rights in respect of dividend or interest ... which are of such a nature (as, for example, if any shares will cease to carry a right to a dividend at a future time) that if the profit distribution ... were to take place in a different accounting period the percentage to which, in accordance with the preceding provisions of this Part of this Schedule, that equity holder would be entitled of profits on the profit distribution ... would be different from the percentage determined in the relevant accounting period.

(2) Where this paragraph applies, there shall be determined—

(*a*) the percentage of profits to which, on the profit distribution, the first company referred to in paragraph 2(1) above would be entitled ...

if the rights of the equity holders in the relevant accounting period were the same as they would be in the different accounting period referred to in sub-paragraph (1) above."

I will return to para 5(3) in a moment. Para 5(4) provides:

"Sub-paragraphs (3) ... of paragraph 4 above shall apply for the purposes of this paragraph as they apply for the purposes of that paragraph and, accordingly, references therein to sub-paragraphs (2)(*a*) ... of that paragraph shall be construed as references to sub-paragraphs 2(*a*) ... of this paragraph."

Thus if there is a class of shares carrying rights which may vary in the future, and if as a result, the parent company's dividend as a percentage of the whole will become less than it is in the current accounting period, the lesser percentage is taken for the purpose of s 28.

Paragraphs 4 and 5 are, as the Judge said, the operative paragraphs.

"Paragraph 4 introduces the requirement that the taxpayer should be entitled to not less than 75 per cent. of the dividends or distributions on a winding-up no matter how large the dividend or distribution, and para 5 the requirement that the taxpayer should be similarly entitled no matter when the dividend or the distribution on a winding-up should occur."

Paragraph 5(5) provides that if there is a class of shares to which both paras 4 and 5 apply, then one applies each paragraph separately, and takes the *lowest* percentage for the purpose of s 28.

I now return to para 5(3) on which the second question turns. It provides:

> "If in the relevant accounting period an equity holder holds, as such, any shares or securities in respect of which arrangements exist by virtue of which, in that or any subsequent accounting period, the equity holder's entitlement to profits on the profit distribution or to assets on the notional winding-up could be different as compared with his entitlement if effect were not given to the arrangements, then for the purposes of this paragraph—
>
> (*a*) it shall be assumed that effect would be given to those arrangements in a later accounting period, and
>
> (*b*) those shares or securities shall be treated as though any variation in the equity holder's entitlement to profits or assets resulting from giving effect to the arrangements were the result of the operation of such rights attaching to the shares or securities as are referred to in sub-paragraph (1) above."

The taxpayer argues that para 5(3) applies, and applies only, where an arrangement exists which could affect the rights carried by the shares in question, whether in the same or some future accounting period. The option agreement was not such an arrangement, since the rights carried by the shares which are the subject of the option agreement would have been precisely the same, whether before or after the exercise of the option. The Crown argues that you look at the taxpayer's overall entitlement to dividend. If an arrangement exists which would reduce the taxpayer's overall entitlement in the future, then you assume that the arrangement has been implemented for the purpose of s 28. The option agreement was such an arrangement, since, if the call option had been exercised, it would have reduced Sainsburys' entitlement from 75 per cent. of the dividend to 70 per cent.

For reasons which I will explain later, I have no doubt that the taxpayers' argument is to be preferred. But first I must deal with the question whether, apart altogether from para 5(3), Sainsburys should be regarded as "the beneficial owner" of 75 per cent. of the share capital.

Beneficial Ownership

As Lord Diplock pointed out in *Ayerst* v. *C & K (Construction) Ltd.* [1976] AC 167, at 177, the concept of beneficial ownership owes its origin to the Court of Chancery(1).

> "The archetype is the trust. The 'legal ownership' of the trust property is in the trustee, but he holds it not for his own benefit but for the

(1) 50 TC 651, at page 670G/I.

benefit of the cestui que trust or beneficiaries. Upon the creation of a trust in the strict sense as it was developed by equity the full ownership in the trust property was split into two constituent elements, which became vested in different persons: the 'legal ownership' in the trustee, what came to be called the 'beneficial ownership' in the cestui que trust."

The term "beneficial ownership" is therefore very well established. It is first found in a taxing statute, so far as I have been able to ascertain, in s 55 of the Finance Act 1927, where it appears in connection with relief from stamp duty on transfers. But in property legislation the term was already familiar to Parliament from s 7 of the Conveyancing Act 1881. Indeed it had appeared even earlier in s 1 of the Larceny Act 1868, and again in the cross-heading to s 58 of the Merchant Shipping Act 1894. But nowhere did Parliament see fit to define beneficial ownership. No doubt this was because it was already a term of art, well known and understood among lawyers.

Mr. Park argued the contrary. He submitted that the term should be given its ordinary meaning, whatever that might be. But that approach finds no support in Lord Diplock's speech in *Ayerst* v. *C & K (Construction) Ltd.* In that case the House of Lords were concerned with s 17 of the Finance Act 1954. Lord Diplock held that the expression should be given the meaning "... which would have been ascribed to it in 1954 as a term of legal art ..."; see [1976] AC 167, at 176.

In *Parway Estates Ltd* v. *Commissioners of Inland Revenue* 45 TC 135 there was an unconditional contract for the sale of the share capital of a wholly-owned subsidiary. Upjohn J. held that, since the contract was one in respect of which the Court would have granted a degree of specific performance, equitable ownership passed to the purchasers at the date of the contract. However at the end of his judgment he said(1):

> "It seems to me, therefore, that, even taking the most technical view of the whole matter, it is not right to describe the vendors at the date of the transfer as the equitable owner. However, I rest my judgment in the main on this: that when you look at the words 'beneficial owner' in s 42 of the Finance Act 1930, those words must in my judgment be construed in what has been described in connection with another Statute as 'its ordinary or popular sense': see *English Sewing Cotton Co. Ltd* v. *Commissioners of Inland Revenue* (1946) 62 TLR 608, at page 610. I do not further refer to that case, for it was dealing with a different Statute. But when one looks at the facts of this case, and asks oneself was the Appellant Company in its popular or ordinary sense the beneficial owner of the shares on 28 February 1956, there can only be one answer to that question: it was not; it was bound by contract to transfer them to another the very next day."

This paragraph lends substance to Mr. Park's argument. But the Court of Appeal expressly repudiated Upjohn J.'s concluding observations. At page 148 Jenkins L.J. said:

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(1) 45 TC 135, at page 142.

A
> "I need only add that I find myself in complete agreement with the learned Judge, who reached the same conclusion as I have done; that is, with one qualification."

Jenkins L.J. then quoted from Upjohn J.'s judgment and referred to *English Sewing Cotton Co. Ltd.* v. *Commissioners of Inland Revenue*. He continued:

B
> "Speaking for myself, I find it difficult as at present advised to derive any assistance from consideration of what the ordinary person would understand by the words 'beneficial owner' in their ordinary sense. I am open to conviction, but *prima facie* it seems to me difficult to ascribe any different meaning to those words from their legal meaning, and that little assistance can be derived from speculation as to what an C ordinary person would take them to mean in their popular sense. For my part, I prefer to found myself on the ground that there is nothing in this agreement to take the case out of the general rule, under which there is no doubt that the equitable interest in the shares became vested in the purchaser when the agreement of 12 January 1956 was signed."

D What then was the "legal" meaning of which Jenkins L.J. spoke? The answer must surely be clear. Jenkins L.J. was assimilating beneficial ownership with equitable ownership. Since the courts would have granted a decree of specific performance of the contract of sale "the well established general principle" applied, and the shares became in equity the property of the purchaser. "One is coming near to saying," he said, "that the vendors have E become trustees of the shares for the purchaser on the strength of the purchaser's right to call for specific performance"; "near to saying" because the vendors were not trustees in the full sense, but in the qualified sense in which that word is frequently used, where the property has passed in equity under a specifically enforceable contract: see for example Megarry and Wade on the Law of Real Property 5th Edition page 602 and the cases there cited. Jenkins F L.J. concluded his judgment at page 148 as follows:

> "The point is not one which admits of any great elaboration, but I cannot see any reason here for excluding the general rule, and if the general rule applies so that Mr. Peck, the purchaser, becomes by virtue of the agreement the owner in equity of the shares in question, then, in my G view, it necessarily follows that at the date of the two transfers the Appellant Company, Parway Estates Ltd., was not the beneficial owner of the share capital of Parr (Builders) Ltd. No doubt, the Appellant Company was the legal owner and the registered proprietor, but the equitable or beneficial interest in the shares had vested in the purchaser."

H
So Jenkins L.J. was, as I say, treating the equitable and beneficial ownership as being one and the same thing.

Similarly, in *Rodwell Securities. Ltd.* v. *Commissioners of Inland Revenue* [1968] 1 All ER 257 it was argued that "beneficial owner" is not a term of art, but is an expression which falls to be construed liberally, so as to include I anybody who has complete control over the disposition of the shares in question. Pennycuick J. rejected the argument. He held that the words have a clear, though undefined, legal meaning, following the judgment of Jenkins L.J. in the *Parway* case, which I have already quoted.

Finally it is worth referring to a decision of Robert Goff J., as he then was, in a completely different field, namely the Administration of Justice Act

1956, s 3(4), now the Supreme Court Act, s 21. Section 3(4) is concerned with the Admiralty Jurisdiction *in rem*. It provides for the jurisdiction to be invoked against "... (*a*) that ship, if at the time the action is brought it is beneficially owned as respects all the shares therein by that person or (*b*) any other ship which at the time when the action is brought, is beneficially owned as aforesaid". In *The Andrea Ursula*[1] [1971] 2 WLR 681 Brandon J. as he then was held that the expression "beneficially owned" should be given a broad meaning so as to cover the case of a ship, which, though not legally or equitably owned by a person, was nevertheless in that person's full possession and control, such as a charterer by demise. In *I Congreso del Partido* [1977] 3 WLR 778 Robert Goff J. declined to follow Brandon J.'s decision. He held that "beneficially owned" referred only to equitable ownership, whether or not accompanied by legal ownership, and did not include possession and control. At page 814 he said:

> "A demise charterer has, within limits defined by contract, the beneficial use of the ship; he does not, however, have the beneficial ownership as respects all the shares in the ship."

So there is good authority for the view that "the beneficial owner" of shares, when that term is used in a statute in contrast to the registered holder, means the equitable owner; neither more nor less. By equitable owner is meant (*inter alia*) the purchaser under a specifically enforceable contract. Applying that test in the present case, GB was not the equitable owner of 5 per cent. of the shares which were the subject of the option agreement, since it could not claim specific performance until it had exercised its option under the agreement, and it could not exercise its option under the agreement until five years after the incorporation of Homebase, namely, 12 November 1984.

Indeed Mr. Park did not even argue that equitable ownership had passed to GB.

Does it follow that equitable ownership remained in Sainsburys? In my view it does. For as Lord Greene pointed out in the *English Sewing Cotton Co.* case it is difficult, at any rate in the case of a contract, to see how the equitable ownership could have become severed from the legal ownership unless it had passed to somebody else. There are, of course, special circumstances in which a person or company may be deprived of the beneficial ownership of his assets, even though it is not yet possible to identify his successors in title. The best known example would be property held by a trustee in bankruptcy, or the property of a company in liquidation; see *Ayerst* v. *C & K (Construction) Ltd.*[2]. Another example would be the estate of a deceased person in course of administration, or assets vested in a Custodian of Enemy Property. In such cases it is right to regard the equitable or beneficial ownership as being in suspense. But in all these cases the legal owner is deprived of his beneficial ownership by operation of law as a consequence of supervening events. I would be reluctant to extend the same concept to the case of an ordinary commercial transaction *inter partes*. So if beneficial ownership means the same as equitable ownership for the purpose of the Taxes Act and if, as Mr. Park concedes, the equitable ownership in the shares have not yet passed to GB, I would be disposed to hold that Sainsburys never ceased to be the beneficial owner of those shares.

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(1) [1973] QB 265. (2) 50 TC 651.

But there remains one authority on which Mr. Park relies strongly, which I have not yet mentiond, namely *Wood Preservation Ltd.* v. *Prior*[1] [1969] 1 WLR 1077. In that case there was a contract for the sale of a subsidiary company. The subsidiary was the UK distributing agent for a German manufacturer. It was a condition of the contract of sale that the vendors would obtain a letter from the German company within one month of the contract assuring the purchasers that the agency agreement would not be terminated. The vendors then assigned their business to the subsidiary, which later claimed to deduct the trading losses of the business from its own profits for tax purposes. At the date of the assignment the letter from the German company had not been obtained. Subsequently the purchasers obtained a satisfactory assurance from the German manufacturers direct. So they wrote to the vendors "withdrawing" the condition. "In these circumstances", they said, "the contract between the two companies has now become unconditional". The question was whether the vendors remained beneficial owners of the shares until the condition was withdrawn, in which case the trading losses would have been deductible, or whether they ceased to be beneficial owners when the contract was made, in which case they would not.

In a lengthy judgment Goff J. held that the vendors had ceased to be beneficial owners at the date of the contract. After referring to *Parway Estates Ltd.* he concluded[2]:

> "It appears to me to follow quite clearly from that authority that ordinarily where the mutual obligation of sale and purchase is subject to a condition precedent the property does not pass so long as the condition remains unperformed, but in the present case I have to consider whether it makes any difference that this was a condition, as I find, solely for the benefit of the purchaser and which he could, therefore, waive. In a sense, therefore, he had a contract of which he could obtain specific performance by, at any time, waiving the condition, but on the other hand he had expressly provided that he would buy the shares subject to the condition of the letter which he needed being produced to him. Mr. Monroe says, 'Well, he could have waived, and if he did waive it the property would then pass to him,' but unless and until he waived it, it would not. That, I think, is not an entirely easy matter to decide, but on the whole I have come to the conclusion that as the matter of waiving the condition rested entirely with the purchaser, he could at any time require specific performance of the contract, and therefore to use the words of Jenkins L.J. in the *Parway* case
>
> 'one is coming near to saying that the vendors have become trustees of the shares for the purchaser on the strength of the purchaser's right to call for specific performance.'
>
> On the whole, therefore, I have come to the conclusion that under this contract the beneficial interest had sufficiently passed to the purchaser and that the conclusion of the special commissioners was right."

It will be seen that Goff J. approached the case much as I have approached the present case, by asking whether the purchasers could have called for specific performance.

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(1) 45 TC 112. (2) *Ibid*, at page 130B/E.

But in the Court of Appeal things took a different turn. Instead of asking whether the purchasers could obtain specific performance by waiving the condition in their favour, the Court of Appeal analysed the nature and extent of the rights retained by the vendors, pending the waiver. In a short judgment Lord Donovan summarised the argument for the Crown as follows(1):

> "The position (they say) even before this condition was waived was this: First, Silexine could not have disposed of the shares to anybody else: had it tried to do so it could have been restrained by injunction. Second, it could not declare or pay any bonus or dividend on its shares: it had specifically precluded itself from doing so. Third, it would have been bound at any time actually to transfer the shares if British Ratin waived the condition in question—which in law at any rate it could have done at any time after the contract was signed. The shares (in a word) were like a tree which the owner could not sell and could not cut down and of which he could enjoy none of the fruit."

He then continued:

> "But if one finds, as here, that the company which made the losses, though still the legal owner of the shares, is bereft of the rights of selling or disposing or enjoying the fruits of these shares, then, bearing in mind the purposes of section 17, I have in the end concluded that it would be a misuse of language to say that it still remained the beneficial owner of these shares.
>
> I am not deciding this case in the least upon the merits; but it is difficult to think that the legislature intended the benefit it was conferring to be enjoyed in these circumstances."

He concluded:

> "It would be rash indeed to attempt an exhaustive definition, and I do not do it. I merely say that the facts in the present case do not, in my opinion, satisfy any reasonable interpretation, involving, as they do, that on March 25, 1960, by the contract of sale of the shares, which was accepted shortly afterwards, Silexine ceased to be able to appropriate to itself any of the benefits of ownership. This does not necessarily involve the consequence that British Ratin became the beneficial owner while the condition remained operative. It is possible for property to lack any beneficial owner for a time, for example property which is still being administered by an executor which will go eventually to the residuary legatee."

Harman L.J. said(2):

> "After accepting this offer [the vendors were] not able to deal with the property in any way at all, as has already been pointed out by my Lord. Therefore it seems to me to be a contradiction in terms to talk about beneficial ownership [of the vendors]. There was no benefit at all in their ownership: it was a mere legal shell ... They were tied hand and foot.
>
> Therefore, merely to say, 'Oh well, this is a conditional contract and in the ordinary way a conditional contract does not pass beneficial own-

(1) 45 TC 112, at page 132A/C. (2) *Ibid*, at page 133D/E.

A ership until the condition is satisfied,' does not seem to me to apply to this case at all, and I think that the Judge was right, though perhaps not quite for the reasons which he gave in his judgment."

Widgery L.J. clearly felt some difficulty, as indeed had Lord Donovan. Since B his judgment is very short, I will quote it in full[1].

"I have found it very difficult to accept Mr. Goulding's proposition that on a contract of sale of this kind the beneficial ownership can leave the vendor without simultaneously arriving in the purchaser. I appreciate that there are many other circumstances in which there may be no identifiable beneficial owner of property, but I would have thought that C where an unquestioned beneficial owner enters into a contract of sale he should be regarded as remaining beneficial owner until that interest has passed to the purchaser.

If that were the right test in this case, I would have thought, contrary to the view of the judge below, that as the beneficial ownership D had not reached British Ratin it remained at the material time in the original owners. But I have been persuaded that, having regard to the problem which is posed to this court, as Lord Donovan has pointed out, one must not look so much at whether beneficial ownership has reached the purchaser: one must examine the situation of the vendor and ask whether the legal ownership, which unquestionably remained in him, E retained the attributes of beneficial ownership for the purposes of the section. In the end, I have reached the same conclusion as that expressed by my Lords on that point and accordingly I also would dismiss this appeal."

F Mr. Park relies on *Wood Preservation Ltd.* v. *Prior* for two purposes: first, to show that beneficial ownership is not synonymous with equitable ownership, and secondly, to show that property may lack a beneficial owner even in a commercial context.

Wood Preservation Ltd. v. *Prior* was considered by Pennycuick J. in G *Brooklands Selangor Holdings Ltd.* v. *Commissioners of Inland Revenue* [1970] 1 WLR 429. On the facts of the latter case, the contract had become unconditional, so that on any view equitable ownership of the stock in question had passed to the transferees. But Pennycuick J. said at page 450:

"I would only add this, that considerable difficulties arise in this H connection if one seeks to equate the expression 'beneficial owner' with the expression 'equitable owner' in the technical sense in which that term is used in equity law ... I do not think, however, that equitable ownership is to be thus equated for this purpose with beneficial ownership although, no doubt, in many instances they may come to the same thing."

I

Although *Brooklands Selangor Ltd.* supports Mr. Park's argument that equitable and beneficial ownership are not the same concept, the observations of Pennycuick J. were necessarily influenced by the decision in *Wood Preservation Ltd.* v. *Prior*.

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(1) 45 TC 112, at pages 133F/134A.

It goes without saying that we are bound by the *ratio decidendi* of *Wood Preservation Ltd.* v. *Prior* whatever it may be. It follows, I think, that we cannot decide the first question on the straightforward ground which I would otherwise favour, that beneficial ownership and equitable ownership are one and the same thing, and that since Sainsburys retained the equitable as well as the legal title to 75 per cent. of the share capital throughout the period in question, they should be regarded as beneficial owner of the five per cent. Instead we must look into the nature and extent of the rights retained by Sainsburys in relation to the five per cent. If Sainsburys were bereft of all rights which would normally attach to that parcel of shares, so that their ownership was, in the words of Harman L.J., nothing more than a legal shell, then we would be bound to hold that Sainsburys were not the beneficial owner of the shares, even though the rights which would normally attach to the shares had not yet passed to GB. Mr. Park submitted that that was precisely the position here.

Mr. Park relies on three factors to establish his argument on the facts. In the first place, Sainsburys had no right to dispose of their shares prior to 12 November 1984, without GB's consent. Secondly, Sainsburys had no expectation of any dividend on their shares, prior to 12 November 1984, since the payment of a dividend was in the joint control of Sainsburys and GB, by virtue of clause 6.4 and 11(vi) of the joint venture agreement. GB would have been most unlikely to agree to the payment of any dividend while the call option remained outstanding. Thirdly, the price at which GB was entitled to purchase the shares under the call option was the aggregate amount paid up on the shares plus interest at 1 per cent. over base lending rate, less the amount of any dividend paid on the shares meanwhile. So if the call option had been exercised, Sainsburys would have been deprived of any increase in the value of the shares. Such increase in value would have accrued to GB, not to Sainsburys, as would any fall in value, should Sainsburys have exercised the put option.

As to these three factors, the first two, as Mr. Park accepted, apply not only to the five per cent, but also to the remaining 70 per cent. It could not possibly be argued that Sainsburys were not, by virtue of these factors, the beneficial owner of 70 per cent. Then does the third factor make all the difference? Mr. Park submits that the cumulative effect of the three factors was such as to deprive Sainsburys of all fruits of ownership. I do not agree. The question is not whether Sainsburys required the consent of GB before a dividend could be paid, or whether a payment of dividend was likely or not (it was clearly contemplated as a possibility). The question is rather whether Sainsburys would have received the dividend if it had been paid. The answer is in the affirmative. The fact that the amount of any dividend would have been deducted from the option price (whether under the call option or the put option) does not mean that Sainsburys were not beneficially entitled to the dividends in the meantime. So I am not persuaded that Sainsburys' rights in relation to the shares were no more than "a mere legal shell". That being so, the ground on which the Court of Appeal held that the vendors in *Wood Preservation Ltd.* v. *Prior* were not the beneficial owners of the shares in question does not apply.

But Mr. Park's argument does not stop there. Assuming Sainsburys were not bereft of all the fruits of ownership, as in *Wood Preservation Ltd.* v. *Prior,* Mr. Park invites us to form what he called a "balanced judgment" as to whether Sainsburys' ownership of the shares was or was not beneficial.

A But I would not for my part be willing to extend the decision in *Wood Preservation Ltd.* v. *Prior* beyond what was actually decided. How, otherwise, could one ever draw the line? Where legal ownership is a mere shell, as it was in *Wood Preservation Ltd.* v. *Prior*, it is relatively easy to draw the inference, as a matter of construction, that Parliament cannot have intended to confer the advantages of group relief. But it is much more difficult to
B draw such an inference where, as in the present case, Sainsburys retained almost all the rights which normally attach to shares in a joint venture company; and even the option agreement did not, for the reasons already mentioned, deprive Sainsburys of all rights in relation to the five per cent, pending the exercise of the call option by GB. So I would not accept Mr. Park's further argument. Like the Special Commissioner and the Judge,
C and for substantially the same reasons, I would answer the first question in favour of the taxpayer.

I have already anticipated my answer to the second question. Once the legislative purpose underlying s 28 and Part 1 of Sch 12 is understood (and I
D confess that the meaning does not exactly leap to the eye) the answer is clear enough. Millett J. held that the option agreement was not an arrangement in respect of any particular shares held by Sainsburys, since Sainsburys could in theory buy in shares from a third party to satisfy the call option. I have some difficulty with that line of reasoning. I much prefer the alternative line of reasoning, that the whole of para 5 is concerned with shares of a certain descrip-
E tion, namely, shares carrying special rights whereby they may, for example, cease to carry the right to any dividend in the future. If that is the right view, then para 5(3) is concerned solely with arrangements whereby shares, or a class of shares, may be brought within that description. An arrangement affecting the ownership of shares is a very different sort of arrangement, and quite outside the ambit of para 5.

F

The learned Judge went on to hold that, for para 5 to operate, the "equity holder" must be the holder of the shares throughout the material time, that is to say, he must be the holder of the shares in the future accounting period to which the arrangement relates, as well as the holder in the current accounting period. The Judge may well be right about that. But it is
G sufficient for present purposes that, for para 5 to operate, the arrangement must be one which affects the rights attaching to the shares. The option agreement was an arrangement which could affect ownership of the shares. But it could not affect the rights attaching to the shares. The fact that those rights would have accrued to the benefit of GB, and not Sainsburys, if the call option had been exercised, is wholly beside the point. The paragraph is
H not concerned with a reduction in the overall right to dividend, but with the reduction in the right to dividend attaching to particular shares. That seems to me to be the plain meaning of the words. It is said that this meaning would emasculate para 5(3). It is sufficient to say that I do not agree.

I I say nothing about the third reason given by the Judge for holding that the option agreement is not caught by s 28 or Sch 12.

For the reasons given I would answer the second question in favour of the taxpayer, as well as the first. It follows that I would dismiss the appeal.

Nourse L.J.:—I agree.

The first question is whether, within the meaning of s 532(3) of the A
Income and Corporation Taxes Act 1970, the "beneficial ownership" in the
five per cent. shares in Homebase Ltd. which were subject to the unexercised
put and call options in favour of GB was vested in Sainsburys or not. The
broad purpose of s 532(3), which was not, in its application to group relief,
modified by the restrictions introduced by the Finance Act 1973, is that in
deciding the extent to which one company is owned by another you look not B
at the legal ownership of the shares but at their beneficial ownership. The
only distinction made is between legal and beneficial ownership and there is
nothing to suggest that the latter expression is to have some special meaning.

There is no difficulty in ascertaining the legal ownership of shares, which
is invariably vested in the registered holder. Equally, it ought not to be diffi- C
cult to ascertain their beneficial ownership, albeit that it may arise in a vari-
ety of ways, for example under a declaration of trust or by operation of law.
I therefore approach the construction of s 532(3), a provision having general
application for the purposes of the Tax Acts, in the expectation that the
extent to which one company is beneficially owned by another was not
intended to depend on fine distinctions between different cases. D

Although I might not, with Lord Diplock, have gone so far as to think
that the expression "beneficial ownership" is a term of art, it is certainly one
which has for several centuries had a very well-recognised meaning amongst
property lawyers. And there can be no doubt that, in enacting a provision
such as s 532(3), Parliament must have intended to adopt that meaning. It E
means ownership for your own benefit as opposed to ownership as trustee
for another. It exists either where there is no division of legal and beneficial
ownership or where legal ownership is vested in one person and beneficial
ownership or, which is the same thing, the equitable interest in the property
in another. Thus, to take the simplest case of divided ownership to which
s 532(3) can apply, if company A is the registered holder of shares in com- F
pany B as nominee, i.e. as a bare trustee, for company C, the beneficial own-
ership of the shares or the equitable interest in them is vested in comapny C.

Another case to which s 532(3) can apply where company A enters into
an unconditional contract to sell shares in company B to company C. Shares
in company B not being readily obtainable in the market, such a contract is G
specifically enforceable at the suit of company C. By parity with contracts
for the sale of land, it has long been held that the right to specific perfor-
mance gives company C the equitable interest in the shares, company A
becoming a qualified trustee in the sense that it must preserve the shares for
company C while remaining entitled to any dividends accruing before com-
pletion. H

In that state of affairs in which of the two companies is the beneficial
ownership of the shares vested pending completion of the contract? It cannot
be doubted that it is vested in company C. In other words, in this instance at
any rate, no distinction is to be drawn between the beneficial ownership and
the equitable interest. As appears from the passages in their judgments in I
Parway Estates Ltd. v. *Commissioners of Inland Revenue* 45 TC 135 to which
Lloyd L.J. has referred, that is an assumption which has in the past been
made by judges as eminent in this field as Lord Jenkins and Lord Upjohn. In
the same company I would cite the observations of Sir George Jessel M.R. in
relation to a contract for the sale of land in *Lysaght* v. *Edwards* (1876) 2 Ch
D 499, 506:

A “It appears to me that the effect of a contract for sale has been settled for more than two centuries; certainly it was completely settled before the time of Lord Hardwicke, who speaks of the settled doctrine of the Court as to it. What is that doctrine? It is that the moment you have a valid contract for sale the vendor becomes in equity a trustee for the purchaser of the estate sold, and the beneficial ownership passes to
B the purchaser ...”

So far therefore I see no reason to doubt that Parliament intended, in the application of s 532(3) to specifically enforceable contracts for the sale of shares, that there should be no difference between the beneficial ownership of
C the shares and the equitable interest in them. Nor, in the absence of authority to the contrary, would I be able to grasp the concept of the beneficial ownership being suspended somewhere between the vendor and the purchaser. I would think that it must be vested in the one or in the other and, if it has not passed to the purchaser, that it must remain in the vendor. That is not in any way to cast doubt on the well-known examples of a suspension of
D beneficial ownership to which Lloyd L.J. has referred. They are far removed from contracts for the sale of land or of shares.

Then take the previous example, but suppose that the contract is subject to a condition precedent. Until the condition is satisfied the equitable interest in the shares will not pass to company C. It will remain in company A. What
E ground is there for thinking that the beneficial ownership of the shares will not also remain in company A? In order to answer that question we must look at *Wood Preservation Ltd.* v. *Prior* [1969] 1 WLR 1077. That is a difficult decision. Goff J. at first instance did not distinguish between the beneficial ownership of the shares and the equitable interest in them. In my view he was right not to make that distinction. However, he thought that, because
F the purchaser could obtain specific performance of the contract by waiving the condition precedent at any time, “... the beneficial interest had sufficiently passed to the purchaser”. I respectfully think that that was an error on the part of the Judge. Unless and until the condition was either waived or satisfied there could be no right to specific performance and no passing of the equitable interest.

G

It seems that Goff J.'s error was perceived by this Court who, in the process of correcting it, gave a decision whose effect was to draw a distinction between the beneficial ownership of the shares and the equitable interest in them. Their approach was bound, as the present case demonstrates, to lead to fine distinctions between different cases in the application of s 532(3).
H Shortly stated, their view was that Parliament could not have intended that the concept of beneficial ownership should apply to the “mere legal shell” of ownership which the vendor there retained. Lord Donovan, at any rate, was prepared to accept that this view might involve a suspension of beneficial ownership. It is to be noted that they did not as that he did not refer, as Goff J. had done, to *Parway Estates Ltd.* v. *Commissioners of Inland Revenue* Lord
I Donovan said that he did not discuss the authorities which had been cited because none of them covered beneficial ownership within the meaning of that expression in s 17 of the Finance Act 1954. That was certainly correct so far as *Parway Estates Ltd.* v. *Commissioners of Inland Revenue* was concerned, because that was a stamp duty decision under s 42 of the Finance Act 1930. However, the conditions for the operation of s 42 were of the same character as the conditions for the operation of s 17. I am not at all sure on

what ground *Parway Estates Ltd.* v. *Commissioners of Inland Revenue* could have been distinguished. A

The decision of this Court in *Wood Preservation Ltd.* v. *Prior* is binding on us for what it decided. I would be unwilling to apply it to any case where the vendor retained more than a mere legal shell of ownership. The grantor of an option which has not been exercised retains much more than that. For B the reasons given by Lloyd L.J. and by Millett J. at first instance, I agree that, within the meaning of s 532(3), the beneficial ownership in the five per cent. of the shares was vested in Sainsburys.

In regard to the second question I do not wish to add anything to the reasoning of Lloyd L.J. and of Millett J. In my opinion the "arrangements" C referred to in para 5(3) of Sch 12 to the Finance Act 1973 were simply not intended to include a transaction of the kind effected by the option agreement in this case.

I too would dismiss this appeal.

D

Ralph Gibson L.J.:—I agree with both judgments.

Appeal dismissed, with costs.

[Solicitors:—Solicitor of Inland Revenue; Messrs. Denton Hall Burgin & Warrens.] E

Printed in the United Kingdom for HMSO.
Dd.0295685, 8/94, C42, 0477, 5673, 264912.