VOL. XXIX—PART IV

HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—
21ST, 22ND, 23RD AND 28TH JULY, 1943

COURT OF APPEAL—9TH, 10TH AND 13TH MARCH AND 2ND MAY, 1944

HOUSE OF LORDS—5TH AND 6TH MARCH AND 17TH MAY, 1945

J. BIBBY & SONS, LTD. *v.* COMMISSIONERS OF INLAND REVENUE[1]

Excess Profits Tax—Whether a "controlling interest" held in a company—Finance (No. 2) Act, 1939 (2 & 3 *Geo.* VI, *c.* 109), *Section* 13 (9).

The issued share capital of the Company, which carried on the business of seed crushing and oil refining, was £1,250,000, *divided into* 750,000 5 *per cent. cumulative preference shares and* 500,000 *ordinary shares of* £1 *each. The ordinary shares alone carried voting rights.*

The directors of the Company held between them in their own right 209,332 *ordinary shares, i.e., less than* 50 *per cent. of the ordinary share capital of the Company.*

Three of the directors, who were brothers and trustees of the marriage settlement of a sister, were, as such trustees, the registered joint holders of 57,500 *ordinary shares. These three directors had a contingent interest in the shares so held, the trust fund being divisible among them in the event of the sister's death without issue.*

The Company was assessed to Excess Profits Tax for the chargeable accounting period of nine months ended 31*st December*, 1939, *on the footing that it was not a company the directors whereof had a controlling interest therein. On appeal against this assessment, the Company contended* (1) *that the three directors had a beneficial interest in the* 57,500 *ordinary shares held in trust, and* (2) *that, in determining whether the Company was director-controlled, the* 57,500 *ordinary shares should be added to the* 209,332 *ordinary shares held by the directors in their own right.*

The Special Commissioners were of the opinion that the 57,500 *ordinary shares did not give the trustee-directors a present interest enabling them and their co-directors to control the Company. They held that the Company was not one the directors whereof had a controlling interest therein, and confirmed the assessment.*

The Court of Appeal held that, apart from the special case of a bare trustee, shares owned by directors as trustees should be taken into account in ascertaining whether the directors of a company have a controlling interest therein.

The House of Lords, without pronouncing upon the part of the judgment of the Court of Appeal dealing with the case of a bare trustee, unanimously affirmed the Order of the Court of Appeal.

(1) Reported (K.B.) 170 L.T. 8; (C.A.) 170 L.T. 370; (H.L.) 173 L.T. 17.

CASE

Stated under the Finance (No. 2) Act, 1939, Section 21(2), and the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 10th April, 1942, J. Bibby & Sons, Ltd. (hereinafter called "the Company") appealed against an additional assessment to Excess Profits Tax in the sum of £1,199 for the chargeable accounting period beginning 1st April and ending 31st December, 1939. The question for determination was whether the Company was one the directors whereof have a controlling interest therein within the meaning of Section 13 (9) of the Finance (No. 2) Act, 1939.

If the Company satisfied that test it would be entitled under Sub-sections (3) and (9) of the above Section 13 to an increase in its standard profits for the standard period (which in this case was, by election under Sub-section (4), the two years ending 31st December, 1936, and 31st December, 1937) of an amount equal to 10 per cent. on the increased capital which it employed in the chargeable accounting period, as compared with the capital employed in the standard period. If, on the other hand, the Company failed to satisfy that test, the increase in the standard profits to which it would be entitled would be 8 per cent. thereof instead of 10 per cent.

2. The Company was incorporated on 12th August, 1914, and is a private company carrying on the business of seed crushing and oil refining.

The authorised and issued ordinary share capital of the Company is £500,000 divided into 500,000 ordinary shares of £1 each, all fully paid. Each ordinary share entitles the holder to one vote.

There are also issued and fully paid 750,000 5 per cent. cumulative preference shares of £1 each, but these shares do not carry any right of voting at any general meeting nor qualify any person to become a director of the Company. No question arises as to these shares.

A copy of the memorandum and articles of association of the Company is attached hereto, marked "A", and forms part of this Case(1).

3. There are eight directors of the Company, holding in their own names and beneficially in their own right a total of 209,332 ordinary shares, i.e., less than 50 per cent. of the ordinary share capital.

Three of the directors, namely, John Pye Bibby, James Edward Bibby and Henry Percy Bibby, are the registered joint holders of 57,500 ordinary shares which they hold as trustees of a marriage settlement dated 1st December, 1916, made upon the marriage of their sister Mary Beatrice Bibby to Frank Deeks Sharples.

This settlement shortly stated contains (*inter alia*) the following provisions:—

Clause 2. Direction for the payment of the income from the said shares to Mrs. Sharples during her life without power of anticipation.

(1) Not included in the present print.

Clauses 3 and 4. After the death of Mrs. Sharples if she should leave a child or children surviving her or issue of any child who should have died in her lifetime then subject to a provision in favour of her husband the trustees shall hold the trust fund upon trust for such children or child, or issue as shall attain the age of 21 years.

Clauses 6 and 9. In the event of the failure of the foregoing trusts in favour of the children of the marriage the trust fund is divisible (subject to a provision in favour of Mrs. Sharples' husband) among such of her brothers and sisters as shall be living at her death with a substitutionary gift in favour of the issue of any brother or sister dying in her lifetime.

Clause 13. Power of appointment over the trust fund to Mrs. Sharples in favour of the children or child of any subsequent marriage.

A copy of this settlement is attached hereto, marked " B ", and forms part of this Case(1).

4. The remaining ordinary shares are all held in such a manner that it was admitted that they could not be taken into account in considering the question of the directors' " controlling interest ", except in so far as they form an element in calculating the total issued ordinary share capital of the Company. A copy of a statement showing the manner in which the shares in the Company were held is attached hereto, marked " C ", and forms part of this Case(1).

5. One of the original trustees of the settlement of 1st December, 1916, died in 1917, viz., Joseph Morton Bibby, and by a deed dated 12th March, 1923, the said Henry Percy Bibby was appointed trustee in his place. From time to time the property comprised in the settlement was augmented as provided for in clause 12 of the said deed of settlement, and in the year in question the number of shares in the Company held by the trustees was, as stated above, 57,500. The settlement comprised certain other assets.

6. Mrs. Sharples has no children, but her husband is alive. The said John Pye Bibby has four children, three of whom are of age. The said James Edward Bibby has four children, two of whom are of age. The said Henry Percy Bibby has three children, all of whom are infants. Mrs. Sharples had two other brothers and a sister, all of whom died unmarried.

7. It was contended on behalf of the Company :—

(1) That the said John Pye Bibby, James Edward Bibby and Henry Percy Bibby being directors and trustees with a personal prospective interest had a beneficial interest in the said 57,500 ordinary shares.

(2) That in order to determine whether the Company was one the directors whereof have a controlling interest therein, the said 57,500 ordinary shares should be added to the said 209,332 ordinary shares.

8. It was contended on behalf of the Commissioners of Inland Revenue :—

(1) That the expression " controlling interest " was not satisfied by control by virtue of ownership as trustees.

(1) Not included in the present print.

(2) That the shares held by the directors in a representative capacity should not be taken into account in considering whether they had a "controlling interest" except in calculating the total issued ordinary share capital.

(3) That shares in which the directors' beneficial interest was merely contingent and partial similarly ought not to be taken into account.

(4) That the directors had not a "controlling interest" in the Company.

9. We, the Commissioners who heard the appeal, were of opinion that the said 57,500 ordinary shares did not give the trustee directors a present interest enabling them and their co-directors to control the Company.

We found that the Company was not one the directors whereof have a controlling interest therein. We confirmed the assessment.

10. Immediately upon our determination of the appeal the Company expressed to us its dissatisfaction therewith as being erroneous in point of law, and in due course required us to state a Case for the opinion of the High Court, pursuant to the Finance (No. 2) Act, 1939, Section 21 (2), and the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

H. H. C. GRAHAM, } Commissioners for the Special Purposes
C. C. GALLACHER, } of the Income Tax Acts.

Turnstile House,
94/99 High Holborn,
London, W.C.1.

12th November, 1942.

The case came before Macnaghten, J., in the King's Bench Division on 21st, 22nd and 23rd July, 1943, when judgment was reserved. On 28th July, 1943, judgment was given in favour of the Crown, with costs.

Mr. J. Millard Tucker, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Company, and the Attorney-General (Sir Donald Somervell, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Macnaghten, J.—The Appellants, J. Bibby & Sons, Ltd., a private company limited by shares, carrying on the business of seed crushing and oil refining, bring this appeal against a decision of the Special Commissioners confirming an additional assessment to Excess Profits Tax for the chargeable accounting period beginning 1st April and ending 31st December, 1939.

The question at issue on this appeal is whether the directors of the Company have "a controlling interest therein" within the meaning of Section 13 (9) of the Finance (No. 2) Act, 1939. If the directors have such an "interest". the Company is entitled, under Section 13 (3) and (9) of the Act, to an increase in its "standard profits"

(Macnaghten, J.)

of an amount equal to 10 per cent. on the increased capital employed in the chargeable accounting period as compared with the capital employed in the standard period. If, on the other hand, the directors have no such "interest" in the Company, the increase in the "stan-"dard profits" would be 8 per cent. instead of 10 per cent. It is, therefore, to the advantage of the Company to establish that the directors have a controlling interest in it.

The capital of the Company was £1,250,000, divided into 750,000 5 per cent. cumulative preference shares and 500,000 ordinary shares of £1 each. All the shares have been issued, and they are fully paid. The holders of the preference shares have no right of voting at any general meeting of the Company; the registered holders of the ordinary shares alone have that right. Upon a show of hands, every holder of ordinary shares present in person at the meeting has one vote; but upon a poll he has one vote for every ordinary share held by him.

There are eight directors of the Company, who are all members of the Bibby family. Between them they hold in their own right 209,332 ordinary shares, which is less than 50 per cent. of the ordinary share capital. Three of the directors, John Pye Bibby, James Edward Bibby and Henry Percy Bibby, are the trustees of the marriage settlement of their sister, Mrs. Sharples; and, as such trustees, they are the registered joint holders of 57,500 ordinary shares. Those shares and the 209,332 shares which the directors hold in their own right, added together, are more than 50 per cent. of the ordinary share capital; and that would give them a "controlling interest" in the Company.

The question, therefore, arises, have the three directors, who are the joint holders of the 57,500 ordinary shares, an interest in the Company? A bare trustee of a share in the capital of a company, it is plain, has no interest in the share; but, under the provisions of Mrs. Sharples' marriage settlement, the trust fund will become divisible among her brothers, the trustees, in the event of her death without issue. Mrs. Sharples, though the marriage took place in 1916, has no children; but her husband is alive. The trustees have, therefore, the contingent interest in the trust fund and in the 57,500 ordinary shares of the Company, which form part of it.

Mr. Tucker, on behalf of the Appellants, submits that the three trustees, having this contingent interest in the shares held by them on the trusts of the settlement, have "an interest in the Company", within the meaning of that expression as used in Section 13 (9) of the Finance (No. 2) Act, 1939. The word "interest" as used in that Section is a word of wide meaning; but it is qualified by the word "controlling". The interest in the Company must be a "controlling" interest; and that, it seems to me, means an interest which gives control. The interest may be direct or it may be indirect, as in the case of the *British-American Tobacco Co., Ltd.*, v. *Commissioners of Inland Revenue*, [1943] A.C. 335; 29 T.C. 49. But it is necessary that the directors between them should, by reason of their interest in the Company, have control over it.

As contingent beneficiaries under the settlement, the three directors have a contingent interest in 57,500 shares; but that contingent interest gives them no control of the Company at all.

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The answer to Mr. Tucker's argument is, I think, this. As trustees they have no "interest" in the shares; and as beneficiaries they have no "control" over the Company; and, therefore, in order to ascertain whether the directors of the Company have a controlling interest therein, the shares held by them as trustees must be excluded. That was the decision of the Special Commissioners, and I think it was right. The appeal must be dismissed with costs.

The Company having appealed against the decision in the King's Bench Division, the case came before the Court of Appeal (Lord Greene, M.R., and MacKinnon and Luxmoore, L.JJ.) on 9th, 10th and 13th March, 1944, when judgment was reserved. On 2nd May, 1944, judgment was given unanimously against the Crown, with costs, reversing the decision of the Court below.

•Mr. J. Millard Tucker, K.C., Mr. J. S. Scrimgeour and Mr. Terence Donovan appeared as Counsel for the Company, and the Solicitor-General (Sir David Maxwell Fyfe, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lord Greene, M.R.—The judgment I am about to deliver is the judgment of the Court.

By Sub-section (3) of Section 13 of the Finance (No. 2) Act, 1939, which is one of the group of Sections dealing with Excess Profits Tax, then for the first time imposed, the standard profits of a trade or business fall to be increased or decreased in relation to any accounting period in which the average amount of capital employed is greater or less than that employed in the standard period. The amount of the increase or decrease of standard profits is to be what is described as "the statutory percentage" of the increase or decrease in the average amount of capital employed. By Sub-section (9) of Section 13, "statutory percentage" is defined as meaning, in relation to a trade or business carried on by a body corporate (other than a company "the directors whereof have a controlling interest "therein"), eight per cent., and in relation to a trade or business not so carried on, ten per cent. Various amendments in the law relating to Excess Profits Tax were made by the Finance Act, 1940, but they do not apply to the year of the present assessment.

The Appellant Company claims that it is a company the directors of which had at the relevant time a controlling interest in it, and that, accordingly, the statutory percentage in its case was ten per cent. The assessment was made in respect of the chargeable accounting period beginning 1st April and ending 31st December, 1939. It was made upon the footing that the appropriate percentage was 8 per cent., and the Special Commissioners decided that this was the correct view. Their decision was confirmed by Macnaghten, J., and the Company now appeals.

The holdings of the directors of the Company, eight in number, were as follows. Between them they held in their own right 209,332 out of the issued ordinary share capital of £500,000 in shares of £1

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each. Three of them were the registered joint holders of a further 57,500 ordinary shares, which they held as trustees of their sister's marriage settlement. Under this settlement, subject to the interests of the sister, her children and issue, they have beneficial interests in the entire capital of the settled funds contingently on their surviving their sister. The ordinary shares are the only shares in the issued capital of the Company which carry voting rights.

The matter for our decision may be stated thus: Ought the 57,500 ordinary shares held by the three directors who are trustees of the marriage settlement to be taken into account in ascertaining whether the eight directors between them "have a controlling in-"terest" in the Company? If so, it is not disputed that the directors have a controlling interest in view of the fact that between them they have more than fifty per cent. of the voting power. If, on the other hand, the 57,500 shares ought not to be taken into account, admittedly the directors have not a controlling interest in the Company.

It was suggested in argument that the question thus raised is a question of fact and not a question of law. We cannot agree. It seems to us to be beyond dispute that, while the question what interest the directors have is one of fact, the question whether such interest is a "controlling interest" is a question of law to be answered by a consideration of the true construction of the language of the statute.

If the reference to "controlling interest" in Sub-section (9) of Section 13 had stood alone, we should have found little difficulty in deciding that the contention of the Company was the correct one. Subject to the one case of a bare trustee who is bound to vote in accordance with the directions of his beneficiary, we can find nothing in the language of the Sub-section which points to an intended distinction between a beneficial interest and an interest held by a trustee. A trustee in whom shares are vested in such circumstances that he has the usual discretion to vote as he thinks fit in the interests of the beneficiaries as a whole appears to us to be a person who, if he holds more than half the voting power, is properly and naturally described as a person who has a controlling interest in the company. He is commonly so described in the language of those familiar with the law and practice relating to companies. Thus, if a shareholder owning more than fifty per cent. of the voting power were to die and bequeath his shares to trustees on trust for his widow and children, and the question were asked: "Who now has "the controlling interest in the company?", no person familiar with company affairs would, I think, answer it otherwise than by saying, "The trustees". It is suggested that this answer would be incorrect in that the trustees are subject to the control of the Court. We do not agree with this suggestion. The controlling interest must obviously be somewhere: it cannot be *in nubibus*; and to say that it is *in gremio judicum* appears to us to violate one's common sense. The distinction between a legal and a beneficial interest is sufficiently well known to justify the belief that, if the Legislature had intended to draw it, it would have said so in express terms.

The case of a bare trustee is not, of course, before us. But it seems to us that, in such a case, the control would naturally be said to be in the beneficial owner and not in the trustee; so that, if the shares carried more than half the voting power and the beneficial

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owner was a director, he would properly be described as having a controlling interest in the company.

But it is pointed out that the phrase "the directors whereof "have a controlling interest therein" is used in other places in the Act, which must accordingly be examined before its meaning in Sub-section (9) of Section 13 can be determined. This is a just observation, and we will now proceed to examine them and the arguments based upon them. It is said that the phrase in the other places where it appears is limited by its context to the case of beneficial interests, and that the same meaning must be attributed to it in Sub-section (9) of Section 13.

The first place in the Act in which the phrase appears is in Sub-section (2) of Section 13 itself. A person carrying on a trade or business to which the Excess Profits Tax applies can elect to have the standard profits taken either at the minimum amount specified in Sub-section (2) or at the amount computed in accordance with Sub-sections (3) to (9). Sub-section (2) provides that the minimum amount is £1,000, or, "in the case of a trade or business carried "on by a partnership or by a company the directors whereof have "a controlling interest therein, such greater sum, not exceeding "£3,000, as is arrived at by allowing £750 for each working pro-"prietor in the trade or business." The expression "proprietor" is defined as meaning, in the case of a partnership, a partner, and, in the case of a company, any director thereof owning not less than one-fifth of the share capital of the company. The expression "working proprietor" is defined by reference to the time worked by a proprietor in the management or conduct of the trade or business.

Two points call for notice here. The first is that a company is entitled to the additional allowance by virtue of the existence of one or more working proprietors whose aggregate share holding cannot, in the normal case, give a controlling interest: the necessary additional shares to give the controlling interest which the directors must have in order to qualify the company for the additional allowance must, therefore, be provided by the remaining directors. The other point is that the only apparent intention of the Legislature is to put a company of the kind described on the same footing as a partnership. Now in the case of a partnership it is by no means true to say that all its members must necessarily own their shares in the partnership beneficially. Cases are not infrequently met with where the executors of a deceased partner enter into partnership with a surviving partner, and so carry on the business for the benefit of the beneficiaries. (See, for example, *Downs* v. *Collins* (1848), 6 Hare 418, where the position of executors having an option to enter into partnership with surviving partners is discussed. See also Lindley on Partnership, 9th edition, at pages 662 and 726.) There is nothing that we can see in the language of the Sub-section to exclude a business carried on by such a partnership from the right to claim the additional allowance, provided the requirement as to one partner at least being a "working proprietor" is satisfied. If the Sub-section applies to a partnership some of the members of which have no beneficial interest, we do not see why it should be necessary to introduce by implication, in the case of a company, the requirement that the interest must be one held by the directors as beneficial owners. It may also be pointed out that, in the Sub-section substi-

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tuted by Section 31 (1) of the Finance Act, 1940, for Sub-section (2) of Section 13, a trade or business carried on "by a single individual" is put on the same footing for the purpose of the "minimum "amount" as one carried on by a partnership or a company whose directors have a controlling interest. Such an individual may be an executor or trustee—there is nothing in the Sub-section which can be construed as excluding him.

But the main weight of the argument was based on Paragraph 10 of Part I of the Seventh Schedule, which sets out the adaptations of Income Tax principles which are to have effect in the matter of computation of profits. That paragraph lays down special rules for a company "the directors whereof have a controlling interest there-"in". In the case of such a company whose standard profits are computed by reference to the profits of a standard period, a limit is put upon the amount of the deduction allowed in respect of "direc-"tors' remuneration". Where the standard profits are not so computed, no deduction is allowed. Sub-paragraph (2) provides that the expression "directors' remuneration" is not to include a director who is employed whole-time in a "managerial or technical capacity "and is not the beneficial owner of, or able, either directly or through "the medium of other companies or by any other indirect means, to "control, more than five per cent. of the ordinary share capital of the "company." The argument, as we understand it, is as follows. The object of the Paragraph is to prevent directors who control the company from raising their own remuneration so as to diminish the taxable profits, Sub-paragraph (2) being inserted in order not to discourage the appointment to the board of managers or technicians holding a small number of shares. The only directors who can properly vote in favour of an increase in their own salaries are, it is said, directors who are beneficial owners of their shares. Trustee-directors who used their votes for the purpose of obtaining such an increase would be committing a breach of trust, and there would, accordingly, be no need to provide that, in the case of a company in which trustee-directors have a controlling interest, increased remuneration should not be deductible. Therefore, the expression "the "directors whereof have a controlling interest therein" must be confined to the case where the interest is a beneficial one.

It seems to us highly unlikely that the Legislature would have left the meaning of the expression to be unravelled by such an elaborate process of ratiocination. The taxpayer is apparently left to discover his position, not by reference to clear words of definition, but by working out for himself the hidden purport of Paragraph 10 and deducing from it the alleged true meaning of the phrase in controversy. If indeed this is what the Legislature has intended to bring about, it seems to us regrettable that the taxpayers who have to pay the taxes and the Courts which have to interpret the statute should be left to thread their way through such dialectical mazes.

But there appears to us to be a serious flaw in the reasoning. It is not, in our opinion, true to say that trustee-directors necessarily commit a breach of trust when they use their voting power to increase their remuneration. In a proper case the Court, if applied to, may well, and not infrequently does, authorise them to do so. We are, of course, assuming that the trustees are entitled to keep their

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remuneration under the terms of the trust or (as not infrequently happens) under an Order of the Court.

It is, however, a legitimate criticism of the argument that in Paragraph 10 itself the phrase "beneficial owner" is used in connection with shares held by a managerial or technical director. Again, in Sub-section (6) of Section 17 of the Act "owned" means "beneficially owned" by virtue of the incorporated provisions of the Finance Act, 1938. In this very statute, therefore, the Legislature is shewing its appreciation of the difference between beneficial and non-beneficial ownership; and, if it intended the same difference to be operative in the case of the shares which give the controlling interest, it seems to us unthinkable that it would not have said so.

Counsel for the Crown, realising no doubt the difficulties which confront an interpretation which limits controlling interest to a beneficial interest, put forward an alternative argument to the effect that such a limitation was not necessary for their purpose. Mr. Stamp suggested that the question was one of fact—a suggestion with which we have already dealt. Both the Solicitor-General and Mr. Stamp argued that, in some cases where trustee-directors have a majority of the voting power and in addition have a beneficial interest in the shares, they can properly be said to have a controlling interest in the company. They gave as an example the case of a trustee-director who is also tenant for life under the will or settlement which comprises the shares. This is a curious suggestion, and we can find no logic in it, when the argument based on Paragraph 10 of Part I of the Seventh Schedule is borne in mind. It was founded upon the supposition that a trustee-director who is tenant for life can without impropriety vote in favour of an increase of his own remuneration, whereas a trustee-director who is only interested in remainder is precluded from doing so. But this is surely not the case. A trustee-director, whatever his own beneficial interest may be, must use his voting power as a shareholder in the interests of the beneficiaries as a whole; and, by voting for an increase in his own remuneration, he is not merely, as was suggested, reducing his own dividends; he may also be reducing the amount which otherwise would be, or ought to be, carried to reserve, a matter which will affect the position of the beneficiaries entitled to the capital of the settled funds. Mr. Stamp went so far as to say that a trustee-director who has a beneficial interest may have a controlling interest for some purposes and not for others, within the meaning of the statute. But the language does not, in our opinion, admit of such an interpretation. The directors either have or have not a controlling interest—it is not possible to say that their possession of a controlling interest depends upon the particular type of resolution on which they are called upon to vote.

It appears to us that, apart from the special case of a bare trustee, there is no half-way house between an interpretation which limits the expression to the case of beneficial ownership and one which includes ownership by trustees, irrespective of the fact whether or not they also have some beneficial interest in the shares which give control. For the reasons which we have given we think that the latter interpretation is to be preferred. If we are wrong in this, we do not think that the position is in any way altered by the existence of the contingent beneficial interests which the trustee-

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directors have in the present case.

In conclusion we must mention two matters, lest it be thought that we have overlooked them. Reference was made to the provisions of the Finance Act, 1937, relating to the National Defence Contribution, where the phrase "the directors whereof have a con-"trolling interest therein" first appears. We do not find it necessary to discuss these references, as they do not appear to us to throw any more light on our problem than the references in the Act of 1939 which we have discussed. The other matter is the decision of this Court in the cases of *British-American Tobacco Co., Ltd.*, v. *Commissioners of Inland Revenue* and *F. A. Clark and Son, Ltd.*, v. *Commissioners of Inland Revenue*, [1941] 2 K.B. 270, and the decision of the House of Lords in the former of these two cases, [1943] A.C. 335(1). These cases were concerned with the meaning of "control-"ling interest" in connection with National Defence Contribution under the Act of 1937, but the questions arising for decision were of a quite different character from that which is now before us, and we do not find anything in the reasoning of the judgments and opinions delivered which can govern our decision in the present appeal.

The appeal is allowed.

Mr. Scrimgeour.—The appeal will be allowed with costs here and below ?

Lord Greene, M.R.—The assessment will be discharged. Must it go back ?

Mr. Scrimgeour.—I think it must go back to be adjusted in accordance with your Lordships' judgment.

Lord Greene, M.R.—It goes back, with the usual Order to the Commissioners.

Mr. Stamp.—I am instructed that this appeal is likely to be more profitable to the Revenue than the taxpayer in the future, having regard to the run of these cases, because sometimes the taxpayer is interested in the one view and sometimes in the other. The result is at any time the taxpayer who is interested in contesting this position may take it to the House of Lords, and it would be convenient if a final decision could be got on this point, which has arisen in scores and hundreds of cases throughout the country.

Lord Greene, M.R.—It is an interesting point because, as you say, it may count one way under one of the Sections and another way under the Section relating to directors' remuneration.

Mr. Stamp.—I am told it is likely to prove more profitable to the Revenue than to the taxpayer—appreciably so—but it is very important that it should be finally decided one way or the other.

Lord Greene, M.R.—Are you prepared to submit to the usual terms ?

Mr. Stamp.—Certainly.

Lord Greene, M.R.—Can you object, Mr. Scrimgeour ?

Mr. Scrimgeour.—I do not think I can resist it.

Lord Greene, M.R.—The Crown very properly offers to bear the expense of contesting this. It will be on the usual terms that you do not seek to discharge the Order as to costs of this Court.

(1) 29 T.C. 49.

Mr. Stamp.— If your Lordship pleases.

Lord Greene, M.R.—And submit to an Order in the House of Lords offering to pay the full costs of the taxpayer as between solicitor and client.

Mr. Stamp.—If your Lordship pleases.

The Crown having appealed against the decision in the Court of Appeal, the case came before the House of Lords (Lords Russell of Killowen, Macmillan, Wright, Porter and Simonds) on 5th and 6th March, 1945, when judgment was reserved. On 17th May, 1945, judgment was given unanimously against the Crown, with costs, confirming the decision of the Court below.

The Solicitor-General (Sir David Maxwell Fyfe, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. J. Millard Tucker, K.C., Mr. J. S. Scrimgeour and Mr. Terence Donovan for the Company.

JUDGMENT

Lord Russell of Killowen.—My Lords, this appeal arises out of an assessment to Excess Profits Tax of the Respondent (which I will refer to as "the Company"), the dispute being whether the Company is entitled to have its standard profits increased by 10 per cent. or only by 8 per cent. The decision depends upon the answer to the question whether the Company is or is not "a company the "directors whereof have a controlling interest therein" within the meaning of Section 13 (9) of the Finance (No. 2) Act, 1939.

The only relevant facts (and they are not in dispute) are these. The Company's issued capital consists of 750,000 £1 preference shares and 500,000 £1 ordinary shares. The preference shares carry no votes. Each ordinary share carries one vote on a poll. There are eight directors, who are respectively beneficial owners and registered holders of ordinary shares which amount to a total of 209,332 shares. Three of the directors are registered as joint holders of 57,500 other ordinary shares, which they hold as trustees of their sister's marriage settlement, under the trusts of which they are entitled to a contingent reversionary interest in the shares. Upon these facts it is apparent that, if these trustee shares are not to be taken into account in considering the question whether the directors have a controlling interest in the Company, the answer must be that the Company is only entitled to an increase of 8 per cent.—its business falls within Sub-section (9) (*a*). If the trustee shares are to be taken into account, the answer would seem equally clear: the Company's business would then fall within Sub-section (9) (*b*), and it can claim an increase of 10 per cent.

Macnaghten, J., affirming the decision of the Special Commissioners, held that the trustee shares must be excluded from consideration. His opinion was thus expressed: "As trustees they have "no 'interest' in the shares; and as beneficiaries they have no "'control' over the Company; and, therefore, in order to ascertain "whether the directors of the Company have a controlling interest "therein, the shares held by them as trustees must be excluded.(1)"

(1) *See* page 172 *ante*.

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This, as I read it, means that the control must be derived solely from voting power attached to shares which are held by the directors and of which the directors are the absolute beneficial owners.

The Court of Appeal took a different view, being of opinion that there was no justification for limiting the phrase "controlling interest" in Section 13 to the case of beneficial interests, and that shares held by the directors as trustees must be taken into account. Further, they were of opinion that the possession by the directors of some beneficial interest in the shares of which they were trustees was an irrelevant fact. I quote their words: "It appears to us that, "apart from the special case of a bare trustee, there is no half-way "house between an interpretation which limits the expression to the "case of beneficial ownership and one which includes ownership by "trustees, irrespective of the fact whether or not they also have "some beneficial interest in the shares which give control.(1)"

My Lords, I agree with the view of the Court of Appeal. When the Section speaks of directors having a controlling interest in a company, what it is immediately concerned with in using the words "controlling interest" is not the extent to which the individuals are beneficially interested in the profits of the company as a going concern or in the surplus assets in a winding up, but the extent to which they have vested in them the power of controlling by votes the decisions which will bind the company in the shape of resolutions passed by the shareholders in general meeting. In other words, the test which is to exclude a company's business from Sub-section (9) (*a*) and include it in (9) (*b*), is the voting power of its directors, not their beneficial interest in the company.

For the purpose of such a test, the fact that a vote-carrying share is vested in a director as trustee seems immaterial. The power is there, and though it be exercised in breach of trust or even in breach of an injunction, the vote would be validly cast *vis-à-vis* the company, and the resolution until rescinded would be binding on it. The contention that upon the wording of Section 13 the interest must be confined to beneficial interests appears to me to be but a repetition of the argument which was rejected by this House in the case of *British-American Tobacco Co., Ltd.* v. *Commissioners of Inland Revenue*, [1943] A.C. 335; 29 T.C. 49, in relation to National Defence Contribution and the Finance Act, 1937.

It may be that, as the Appellants contended, an object of the Sub-section now in question was to compensate a director-controlled company for the disability imposed on it by Paragraph 10 of Part I of the Seventh Schedule to the Act, but I cannot deduce from this fact, if it be a fact, that controlling interests must be confined to beneficial interests which give control. I agree with the view of the Court of Appeal that, upon the true construction of Sub-section (9) of Section 13, standing alone, there could be no justification for so restricting the words or reading into the Sub-section a provision to the effect that control held as a trustee should be disregarded.

A long and detailed argument was, however, addressed to us, based upon other Sections of the 1939 Act and some provisions of the Finance Act, 1937, in which the phrase "the directors whereof "have a controlling interest therein" occurs, and in which it was contended that the word "interest" was necessarily limited to a

(1) *See* page 176 *ante*.

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beneficial interest. Therefore, it was said, the word must be so limited in Section 13 (9).

Thus the provisions in Paragraphs 4 (*b*), 7 (*b*), 11 and 12 of the Fourth Schedule to the Finance Act, 1937, were relied upon for this purpose. They are provisions which (to put it shortly) prohibit or restrict the permissible amount of deductions from profits in the case of companies "the directors whereof have a controlling interest "therein". The deductions being deductions in respect of payments which the company would be making to the directors, or some or one of them, for their or his own beneficial enjoyment (for example, for remuneration or rent), it follows, so it was contended, that the controlling interest must also be one enjoyed by them beneficially. With all respect to those who advance this argument, I can only answer, "*non sequitur*." I can find in it no compulsion so to restrict the meaning of the words "controlling interest". Reliance was also placed on Section 13 (2) (*b*) of the Finance (No. 2) Act, 1939, in which, it was said, the phrase, "owning not less than one-fifth of the share "capital" could not mean owning as trustee, and, therefore, the controlling interest referred to earlier in the Sub-section could not refer to an interest owned as trustee. I am not prepared, as at present advised, to concede the first part of this proposition. Director-controlled companies are as a rule private companies, in which trustee-directors are a not uncommon feature, just as in partnerships one may find a partner who, as the representative of a deceased former partner, is carrying on the business for the benefit of beneficiaries in partnership with a surviving partner.

Much reliance was placed on the provisions contained in Paragraph 10 of Part I of the Seventh Schedule to the Finance (No. 2) Act, 1939. The argument founded thereon is fully stated and dealt with in the judgment of the Court of Appeal. I need only say that I agree with the criticism and conclusion contained in that judgment. I agree also with the sympathy expressed with the taxpayer, who (according to the Appellants) has to discover the true meaning of Section 13 (9) of the Finance (No. 2) Act, 1939, by a close scrutiny and analysis of other provisions of that and other Finance Acts. If his scrutiny and analysis were sufficiently close he might notice that Sub-paragraph (2) of the same Paragraph 10 suggests that a registered shareholder who is not a beneficial owner may directly control ordinary shares; and he might perhaps wonder, on reading the Finance Act, 1940, why the Legislature had not inserted in the 1939 Act a provision similar to that which is contained in Section 55 (5) of the Act of 1940.

Counsel for the Appellants, at one stage of the argument, suggested that shares registered in the name of a director but held by him as trustee might be included in reckoning the controlling interest in cases where the trustee had also what was described as a predominating beneficial interest in the shares. For myself I am unable to appreciate how these supposed different degrees of beneficial interest, or the existence in the trustees of any beneficial interest, can affect the question of control. The words "controlling interest" mean "controlling voting power": that is the interest in view, not beneficial interest. As at present advised I agree with the Court of Appeal in the view that there is no half-way house between a construction which restricts the controlling interest to shares which

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are in the absolute beneficial ownership of the trustees and a construction which includes all shares of which the directors are registered holders. It is true that the Court of Appeal except the case of what they describe as a bare trustee, but express a view that the control would reside in the beneficial owner of the shares. The case envisaged is, no doubt, the case of the director who puts shares into the name of a nominee, taking probably a blank transfer executed by the nominee. I prefer to express no definite opinion in relation to this question, but to keep it as an open question to be debated when the necessity for a decision thereon in fact arises.

I would dismiss this appeal with costs to be taxed as between solicitor and client in accordance with the undertaking given by the Appellants to the Court of Appeal.

My Lords, my noble and learned friend **Lord Wright**, who is unable to be present today, has asked me to say that he concurs in the opinion which I have just delivered.

Lord Macmillan (read by Lord Porter).—My Lords, the question is whether the directors of the Respondent Company have "a con-"trolling interest therein" within the meaning of Section 13 (9) (*a*) of the Finance (No. 2) Act, 1939. The answer will affect the extent of the Company's liability to Excess Profits Tax for the chargeable accounting period from 1st April to 31st December, 1939. The Company employed in its business in that period an average amount of capital greater than the average amount employed in the standard period, and is, therefore, entitled to have its standard profits increased by a statutory percentage of the increase in its capital. If the directors have a controlling interest in the Company, the statutory percentage applicable is 10 per cent.; if not, the statutory percentage applicable is 8 per cent.

The control of a company resides in the voting power of its shareholders. In the Respondent Company the ordinary shares alone confer a right to vote at a general meeting. The directors are the registered proprietors of a majority of the ordinary shares. It would therefore appear to follow that the directors have a controlling interest in the Company.

The Appellants, however, maintain that this is not so, for the reason that certain of the ordinary shares held by three of the directors are held by them as trustees under the marriage settlement of their sister. The contention is that these trust shares must, on a sound interpretation of the statute, be excluded from the reckoning for the present purpose, because the directors in question have not the sole, or at least not a predominant, beneficial interest in them. It is agreed that if these shares be excluded, then the directors do not among them hold a majority of the ordinary shares and so do not have a controlling interest in the Company.

In my opinion the Court of Appeal rightly rejected the contention of the Inland Revenue Commissioners. The question whether the directors of the Respondent Company have the control of it by their voting power as shareholders must, in my view, be determined by the memorandum and articles of the Company and by the register of shareholders. By the constitution of the Company, as I have already mentioned, the voting power is vested in the ordinary shareholders, and the register shows that the directors hold a majority of these

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shares. As was said by Sir George Jessel, M.R.: "The company "cannot look behind the register as to the beneficial interest, but "must take the register as conclusive, and cannot inquire . . . into "the trusts affecting the shares"—*Pulbrook* v. *Richmond Consolidated Mining Company* (1878), 9 Ch. D. 610, at page 615. So far as the company is concerned the relation between such of its shareholders as happen to be trustees and their beneficiaries is *res inter alios*. It may be that a trustee-shareholder may, as between himself and his *cestuis que trust*, be under a duty to exercise his vote in a particular manner or a shareholder may be bound under contract to vote in a particular way (compare *Puddephatt* v. *Leith*, [1916] 1 Ch. 200). But with such restrictions the company has nothing to do. It must accept and act upon the shareholder's vote, notwithstanding that it may be given contrary to some duty which he owes to outsiders. The remedy for such breach lies elsewhere.

Suppose that all the shares held by the directors in the present case were held by them as trustees, could it be said that they did not control the Company? If so, then in whose hands was the control of the Company?

The learned Solicitor-General, in maintaining that the statutory words, "a company the directors whereof have a controlling interest "therein", should be expanded by the addition of the words, "by "reason of their being the beneficial owners in the aggregate of "shares entitling them to a majority of votes", submitted that the reason for the legislation justified this implication. The extra 2 per cent., he said, was by way of compensation for the restriction imposed elsewhere in the Act on the diversion of profits by directors to their own remuneration, but, as it would be improper for trustee-shareholders to vote for an increase in their remuneration as directors, at least without the consent of their beneficiaries, there was not the same need for the restriction in their case. This may be so, but I do not think that it is a sufficient justification for so extensive a qualification of the plain words of the statute. Your Lordships were also referred to other instances of the use of the phrase "controlling interest" elsewhere in the Act, and also in the Finance Act of 1937, as supporting the Crown's contention. But this proved rather double-edged, for in one instance in the 1939 Act there occurs the expression, "the beneficial owner of ... more than five per cent. "of the ordinary share capital of the company" (Seventh Schedule, Part I, Paragraph 10 (2)), which at least suggests that when the Legislature means beneficial ownership it knows how to say so. I remain unconvinced by this line of argument.

It so happens that the three directors in question have a remote contingent beneficial interest in the trust for which they hold shares. In the view which I take this is immaterial, but, if beneficial interest were necessary, then, unless beneficial interest were taken to mean sole beneficial interest, I can conceive complicated questions arising as to the extent of the beneficial interest of the shareholder in particular cases, which would be unfortunate for the working of an emergency taxing measure.

I would only add that I have not overlooked the fact that this legislation applies to Scotland as well as to England, and that in Scotland trustee-shareholders are registered as such. The Act should, if possible, receive an interpretation which will be equally applicable

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on both sides of the Border. "In construing a taxing statute which "applies to England and Scotland alike, it is desirable to adopt a "construction of statutory words which avoids differences of inter-"pretation of a technical character such as are calculated to produce "inequalities in taxation as between citizens of the two countries"—*Rex* v. *General Commissioners of Income Tax for the City of London* (ex parte *Gibbs and Others*), [1942] A.C. 402, per Lord Chancellor Simon, at page 414; 24 T.C. 221, at page 244. I find no reason in the circumstance to which I have alluded for thinking that it would lead to a different result in Scotland. The reason why in Scotland trustees as such are entered in the share register is very fully explained in the case of *Muir* v. *City of Glasgow Bank* by Lord President Inglis in the Court of Session and Lord Chancellor Cairns in this House ((1878) 6 R. 392, at page 400; (1879) 6 R. (H.L.) 21, at page 26; 4 App. Cas. 337, at page 360). It would be inappropriate to go into the matter here. Suffice it to say that, so far as his position *vis-à-vis* the company is concerned, the trustee-shareholder whose name appears as such in the register is, as regards his rights and liabilities, in exactly the same position as a shareholder who is not a trustee.

I am accordingly in agreement with your Lordships that this appeal should be dismissed.

Lord Porter.—My Lords, I have had an opportunity of reading, and agree with, the opinions of my noble and learned friends, Lord Russell of Killowen and Lord Simonds. I cannot doubt that by the expression, "a company the directors whereof have a controlling "interest therein" is meant a company in which the directors by means of their shareholding are able to direct the affairs of the company according to their will.

This is, in my view, the natural meaning of these words. It was, however, argued that, if one looked at the object of the Act and searched its phraseology, one would find that they bore the narrower meaning contended for on the part of the Crown, and that to have a controlling interest necessitated the existence of a beneficial interest in those who exercised control.

My Lords, speaking for myself, I do not find any object apparent in the Act inconsistent with that expressed in the words themselves, and, like the Master of the Rolls, I am unable to believe that the construction of the vital expression is to be ascertained by means of a meticulous search through obscurely worded portions of the Act in order to find a meaning which is not naturally apparent.

It was, however, urged that the use of the words "controlling "interest" showed that there must be both control and an interest, and that a person who was merely a trustee might control but could not be said to have an interest.

This contention to my mind lays far too great emphasis on the word "interest". I do not think one is entitled to split up the phrase and press the meaning of each portion in this way. The phrase is a composite one, and the combination means no more than that the directors must have an interest such as enables them to control the activities of the company; it does not require some personal financial interest on their part which control enables them to exploit. It may be that trustees can ultimately be brought to book

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for activities which would not lay a beneficial owner open to attack or complaint. Nevertheless, for good or ill the trustee, like the beneficial owner, controls, though if his powers be wrongly exercised they may in some way or other be capable of being challenged.

The Court of Appeal qualify the meaning of the phrase by excepting "bare trustees" from those having a controlling interest. As to this qualification I desire to reserve my decision. In a case such as the present, however, where the shares giving control are held by the directors not merely as trustees but also with some personal interest as well, I cannot doubt that the holders have a controlling interest.

I would dismiss the appeal.

Lord Simonds.—My Lords, the question for your Lordships' decision is whether, in the case of the Respondent Company, the statutory percentage in respect of the increase in the average amount of its capital, which is allowed under Section 13 (3) and (9) of the Finance (No. 2) Act, 1939, for the purpose of assessing Excess Profits Tax, should be 10 per cent. or 8 per cent. This depends on the answer to the further question whether the Respondent Company is "a company the directors whereof have a controlling interest "therein". If yea, the percentage is 10 per cent.; if nay, it is 8 per cent. only.

The material facts can be stated very shortly. The Respondent Company has a capital of preference and ordinary shares. The preference shares can upon a question of control be disregarded. There have been issued 500,000 ordinary shares of £1 each, all of them fully paid and carrying the usual voting powers. There are eight directors, who beneficially own, and are registered as the holders of, 209,332 ordinary shares. In addition, three of them are registered as the holders of 57,500 ordinary shares, which they hold as trustees of a certain marriage settlement. Under this settlement they have a contingent reversionary interest in the settled funds. The question is whether these 57,500 shares ought to be added to the 209,332 shares for the purpose of determining whether the directors have a controlling interest in the Company.

What, my Lords, constitutes a controlling interest in a company? It is the power by the exercise of voting rights to carry a resolution at a general meeting of the company. Can the directors of the Respondent Company by the exercise of their voting rights carry such a resolution? Yes: for they are the registered holders of more than half the ordinary shares of the Company. Therefore they have a controlling interest in the Company.

From this result the Crown seeks an escape by the contention that shares held by a director as trustee should not be included for the purpose of computing the controlling interest. In the Appellants' argument in this House and in their formal reasons this absolute veto is qualified by the suggestion that, if the director has not only the legal ownership of shares but also a predominating beneficial interest in them, they may be brought into the count.

My Lords, in my opinion the Crown's contention cannot be sustained. Those who by their votes can control the company do not the less control it because they may themselves be amenable to

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some external control. Theirs is the control, though in the exercise of it they may be guilty of some breach of obligation, whether of conscience or of law. It is impossible (an impossibility long recognised in company law) to enter into an investigation whether the registered holder of a share is to any and what extent the beneficial owner. A clean cut there must be. It is for this reason that, while respectfully concurring in every other line of the judgment of the Master of the Rolls, I would reserve further consideration of that part of it which deals with the case of the so-called bare trustee. His case is not yet before your Lordships and perhaps never will be. If and when it is, the validity of the distinction made by the Master of the Rolls will have to be considered, and I should myself require a more satisfactory explanation than has yet been given of a term which, though it has statutory sanction, has never, I believe, received statutory definition.

That the meaning which I have given to the words "controlling "interest" is their natural and proper meaning I have no doubt. But the great part of the argument on behalf of the Crown has been directed to showing that, to some extent in regard to this very provision, but more particularly in regard to other provisions of the same Act relating to Excess Profits Tax, the purpose of the Act will be defeated unless the beneficial interest alone is regarded and the fiduciary interest disregarded. This is a cogent argument, if two conditions are satisfied, first, that the words in dispute fairly admit an alternative construction, and second, that the purpose of the Act can be so clearly seen that one construction will serve it and the other defeat it. Neither of these conditions is, in my opinion, satisfied. I cannot ascribe to the words "controlling interest" a meaning which would impose alike on the taxpayer and the tax-collector the duty of searching out the beneficial interest behind the veil of legal forms. For it is to be observed that, if this argument is to be effective, it is not sufficient to say that the controlling interest lies not with the legal owner, but with the beneficial owner; the next step is to determine who, amidst all the complexities of successive interests, discretionery interests, mortgage and other interests, is for this purpose to be regarded as the beneficial owner. I must decline to admit an alternative construction which, departing from the plain and simple meaning of familiar words, requires such an unravelling. Nor is it so clear to me that, at least in respect of the provision now under review, the construction that I adopt is not consonant with what appears to be the purpose of the Act. But however this may be, and whatever may be the difficulties if this same construction is to be applied to the words in question where they occur in other parts of the Act, and particularly in Paragraph 10 of Part I of the Seventh Schedule (a matter upon which I express no opinion), I cannot allow myself to be deflected by such considerations from the plain and unambiguous meaning of the provision now under review.

I agree that this appeal should be dismissed.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and the appeal dis-

missed with costs, such costs to be taxed as between solicitor and client in accordance with the undertaking given by the Appellants to the Court of Appeal.

The Contents have it.

[Solicitors:—Layton & Co.; Solicitor of Inland Revenue.]