Analysis

1.5% stamp tax charge: continuity or change?

Speed read

The Finance Act 1986 contains charges to stamp duty reserve tax and stamp duty at a rate of 1.5% on the issuance and transfer of securities to a depositary receipt issuer or clearance service. The EU Capital Duties Directive disapplied these charges in many contexts, and this disapplication remained effective (as retained EU law) after the end of the Brexit implementation period. The enactment of the Retained EU Law (Revocation and Reform) Act 2023 cast doubt on the future of this EU-derived exemption; the government has now announced its intention to keep it, and has published draft legislation for consultation.

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On 14 September 2023, the government issued a statement announcing its intention to amend the Finance Act 1986 (FA 1986) so that, with effect from 1 January 2024, the 1.5% charge to stamp duty reserve tax (SDRT) will not arise on any issuance of securities to a depositary receipt issuer or clearance service, and SDRT or stamp duty at 1.5% will not arise on any transfer of securities that is within the scope of a new statutory exemption. Draft legislation has been published, subject to consultation.

The statement provides much-needed clarity for UK-parented groups whose securities trade on non-UK exchanges – including companies with American depositary shares (ADSs) listed in the US, and companies whose securities may trade directly through the Depository Trust Company (DTC) or a European clearance service. It is especially helpful to groups that may be considering becoming listed on such exchanges in the future, whether through an IPO, a secondary listing to access a new pool of capital, or through the acquisition of an overseas public company involving equity consideration.

However, whilst the swift publication of draft legislation is appreciated and very helpful, the proposed exemptions it contains appear to mark a departure from the principles laid down in CJEU case law, and may raise practical difficulties.

The draft legislation also repeals the 1.5% charge to stamp duty on the issuance of bearer instruments, and makes other minor amendments.

1.5% charge and EU law

FA 1986 ss 67 and 70 contain charges to stamp duty at a rate of 1.5% on instruments which transfer securities to a depositary receipt issuer or clearance service. Equivalent provisions, in FA 1986 ss 93 and 96, impose SDRT at the same rate on such transfers, and additionally on issuances.

The practical effect of these provisions has however been substantially curtailed by decisions of the CJEU (in *HSBC Holdings plc and Vidacos Nominees Ltd v HMRC* (Case C-569/07)) and the First-tier Tribunal (in *HSBC Holdings plc and The Bank of New York Mellon Corporation v HMRC* [2012] UKFTT 163 (TC)). These decisions established that the 1.5% charge is unlawful in a number of scenarios owing to its incompatibility with the EU Capital Duties Directive (Council Directive 2008/7/EC of 12 February 2008 concerning indirect taxes on the raising of capital), and predecessor rules. Following these cases, HMRC published guidance confirming that it would not collect SDRT on issuances, or on transfers that are 'an integral part of an issue of share capital', to a depositary receipt issuer or clearance service. However, crucially, unlike in other situations where HMRC lost cases before the CJEU, the relevant UK legislation was never amended so as to conform with EU law.

The position under the Capital Duties Directive did, nevertheless, survive Brexit, becoming 'retained EU law' through s 4 of the European Union (Withdrawal) Act 2018.

> Numerous representations were made to HMRC and the government over the summer

It was against this (already storied!) backdrop that the Retained EU Law (Revocation and Reform) Act 2023 (REULA 2023) received royal assent on 29 June 2023. Section 2 of REULA 2023 provides for the 'sunset' of a large body of retained EU law (including rights under the Capital Duties Directive) at the end of this year, subject to a mechanism that allows ministers and certain public bodies to save laws from repeal. Without any indication of whether this power would be exercised, the enactment of REULA 2023 raised the prospect of the 1.5% charge springing back to life, with SDRT and stamp duty being reinstated from the end of the year in circumstances where it had been disapplied for over a decade. (See 'Stamp duty on share issues' (Mike Lane), *Tax Journal*, 5 July 2023.)

Period of uncertainty

There followed a period of uncertainty as to government policy. Did the government still consider itself bound by the statement, made in the Autumn Budget of 2017, that it would not reintroduce the 1.5% charge following Brexit?

There was nervousness in some quarters that the 1.5% charge might become entangled in government efforts to promote the UK capital markets (which have been given renewed urgency following the much-publicised IPO of Arm Holdings plc on Nasdaq). It is no secret that there is a 0.5% SDRT charge when UK shares listed on the main market of the London Stock Exchange are transferred within CREST, whereas there is no SDRT on the transfer of an ADS or of a share held within an overseas clearance service which has not made an election under FA 1986 s 97A (although there is a question as to what extent this difference is reflected in pricing, and there is parity of treatment for companies admitted to trading on AIM, which benefit from the growth market exemption in FA 1986 s 99(4B)). However, it seems unlikely that reinstating the 1.5% charge would have been a decisive factor in leading companies to float in London. Conversely, it may have led to wider, unintended, adverse consequences for the UK.

The reality is that the commercial attractiveness of an overseas listing, especially in the US, can be compelling. Bear in mind that, to effect an IPO, it is normally necessary, for corporate law reasons, to establish a new holding company. That new holding company doesn't need to be incorporated in the UK. The prospect of a 1.5% charge might, alongside a variety of other factors, have influenced the location of the holding company. It is not impossible that an internationally-focused group, convinced of the benefits of the US markets, could have been tipped towards listing through (taking one example) a US corporation. Although the UK corporate tax system is in many other ways more attractive, and headline rates clearly don't tell the full story, especially for holding companies, attention is sometimes given to the fact that the current US federal corporate income tax rate of 21% compares favourably with UK corporation tax at 25%. In certain sectors, it is possible that the result could have been more 'Delaware flip' transactions (where a US holding company is inserted above the UK entity; Delaware being the US state in which such companies are most commonly established). A decade or so after the trend of 'inversion' transactions (where US groups 'inverted' under new holding companies in the UK and elsewhere), there was a risk that the tables could have turned.

Draft legislation: key points

It is understood that numerous representations were made to HMRC and the government over the summer. It is therefore welcome that the government has made its announcement soon after Parliament returned from its recess and that it has already published draft legislation.

The draft legislation takes the form of a schedule containing amendments to the relevant provisions of FA 1986. The schedule (and its short introductory section) are to be included in an upcoming Finance Bill.

The draft legislation, and in particular the second condition for exemption from a 1.5% charge on transfers, may be seen as an attempt to create a statutory 'integral' test

Starting with the most straightforward aspect of the draft legislation, in relation to issuances: the 1.5% SDRT charging provisions are to be amended, by the deletion of the words 'or issued' from FA 1986 ss 93(1)(b) and 96(1)(b). This will entirely remove the issuance of chargeable securities to a depositary receipt issuer or clearance service from being an event giving rise to SDRT.

In relation to transfers, the draft legislation does not remove the 1.5% charge completely; instead, it is retained but becomes subject to new exemptions for any 'exempt capital-raising instrument' (in the case of stamp duty) and any 'exempt capital-raising transfer' (in the case of SDRT).

These exemptions both operate by taking transfers out of the 1.5% charge where one of two conditions is met.

The first condition is met if the transfer is in the course of capital-raising arrangements. 'Capital-raising arrangements' are defined as 'arrangements pursuant to which relevant securities are issued by a company for the purpose of raising new capital'.

The second condition is met, broadly, where: (a) a person acquires securities, either before or in the course of capital-raising arrangements, (b) that person is subject to a prohibition that has the effect of preventing the transfer in the course of the capital-raising arrangements, and (c) the transfer is made as soon as reasonably practicable after the time at which the prohibition ceases to have effect.

An interesting detail to note is that the draft introductory section frames the schedule as a set of provisions 'ensuring that it *continues to be the case* that' no stamp duty or SDRT arises on the issuance or transfer of securities in the course of capital-raising arrangements. This implies that the government regards its approach as placing the disapplication of the 1.5% charge as it exists currently as retained EU law on a permanent statutory footing – in other words to achieve continuity, rather than to effect a change.

Preservation of the status quo?

For issuances, the removal of the 1.5% charge mirrors the position under retained EU law, i.e. that no SDRT (or stamp duty) should arise.

For transfers, the position in retained EU law is often summarised (including in HMRC guidance, as quoted above) as being an exemption for transfers that are an integral part of an issue of share capital. As noted in a previous article, whilst this summary is arguably oversimplistic (and a narrow interpretation of the CJEU's reasoning, conflating the prohibitions in articles 10 and 11 of the predecessor rules to the Capital Duties Directive), HMRC has in practice given the 'integral' test a broad meaning (see 'UK companies listing in the US' (Jonathan Cooklin and David Wilson), *Tax Journal*, 13 March 2014).

This broad interpretation was supported by the later case of *Air Berlin plc v HMRC* [2017] EUECJ (Case C-573/16), the high-water mark of the Capital Duties Directive's application in UK law (albeit that some of the court's statements in that case may, arguably, be obiter). A key aspect of the CJEU's reasoning in *Air Berlin* is that, according to its own case law (including in the first *HSBC* case), the Capital Duties Directive must be 'interpreted broadly so as to ensure that the prohibitions laid down in those provisions are not denied practical effect'. (See 'Brexit, Air Berlin and the 1.5% stamp duty charge: reasons to be cheerful' (Jessica Kemp), *Tax Journal*, 16 January 2018.)

The draft legislation, and in particular the second condition for exemption from a 1.5% charge on transfers, as referred to above, may be seen as an attempt to create a statutory 'integral' test – essentially as a continuation of the status quo. However, there is a concern that certain aspects of the second condition could cause difficulties which might limit the practical effect of the exemption from the 1.5% charge – which would be contrary to the principle set out in *Air Berlin* and, rather than providing continuity, would represent a change to the current position under retained EU law.

The first area of potential difficulty is the requirement for a 'prohibition' that prevents the transfer from taking place at the same time as the relevant capital-raising arrangement. There is no definition of prohibition for these purposes, although the term seems designed to cover customary 'lock-up' arrangements (whereby certain shareholders may not sell their shares/ADSs for a specified period following an IPO), and situations where local securities laws impose restrictions on transfers of or dealings in the securities. Given this context, presumably contractual, as well as regulatory or other external legal prohibitions, are accommodated? But what happens if a transfer to a depositary or clearance service is prevented by insurmountable practical or operational considerations, rather than a strict legal prohibition? What happens if a company and/or its shareholders take a different interpretation of the regulatory framework to the depositary or operator of a clearance service? The answer to some of these and certain other questions is not clear, and it may potentially be the case that relatively common scenarios and structures that have fallen within the existing exemption (as being 'integral') will no longer do so. Without clearer legislation or at least detailed guidance, it remains to be seen how depositary banks and clearance system operators would satisfy themselves that a 'prohibition' is present.

A second area of potential difficulty is the requirement that any post-prohibition transfer should take place 'as soon as reasonably practicable' after the relevant prohibition falls away. Again, there could be uncertainty as to what meets this standard. The authors would suggest that a sensible statutory safe harbour, of perhaps three months following the end of the relevant prohibition, would benefit all parties and remove the need for clearances to be obtained on what ought not to be a controversial point.

Separately, it is noted that the draft legislation seems not to accommodate situations in which a listing takes place (with an accompanying transfer of securities into a depositary receipts system or clearance service) without there being a new raising of capital.

It is hoped that some or all of these points can be addressed during the consultation process.

> The government's decision to legislate through a Finance Bill does, however, raise a question on timing

Timing

The government's decision to address the problem caused by REULA 2023 through amendments to the primary legislation is a positive one. Giving the rules a clear statutory footing within FA 1986 should certainly help simplify some of the tortuous drafting which is currently seen in public disclosure and legal opinions.

The government's decision to legislate through a Finance Bill does, however, raise a question on timing. Under REULA 2023, as mentioned above, retained EU law will no longer apply after the end of this year unless steps are taken to preserve it. A Finance Bill is however unlikely to be enacted until well after 1 January 2024. The draft legislation states that its commencement date is 1 January 2024. It follows that, once enacted, it should be retroactive from this date. But what happens during the interim period, between 1 January and enactment? Will it be necessary to pay the tax and claim it back once the new rules are in force? This would cause serious practical difficulties.

One solution to this problem could be for the government to make the legislation effective prior to its enactment by way of resolutions of the House of Commons under the Provisional Collection of Taxes Act 1968 s 1 (for SDRT) and FA 1973 s 50 (for stamp duty). This route is not without complication, however: any resolutions made under those provisions would cease to have effect at short notice if certain events were to occur – including if Parliament were to be dissolved to allow an early general election – which could be a concern, in particular, for a company launching an IPO. It may therefore provide greater certainty if the draft legislation could be made law (even if on a temporary basis, pending enactment of the Finance Bill) using the powers granted under REULA 2023.

Other changes to the depositary receipt and clearance service legislation

The draft legislation makes a number of other changes, which it terms 'minor and consequential' – but which are nonetheless useful.

The old anti-avoidance rule in FA 1986 s 97C is to be repealed. This section, a trap for the unwary, concerns transfers from EU to non-EU depositary receipts systems and clearance services, and is a hangover from the first *HSBC* case. HMRC initially interpreted this case as holding that the Capital Duties Directive applied only within the EU – at least until this reasoning was refuted in the second *HSBC* case.

The instalment payments rules in FA 1986 ss 93(10) and 96(8) are also to be repealed.

It is pleasing to see some tidy-ups in the spirit of the rewrite project, signposting the new exemptions and generally assisting the navigation of this complex legislation.

Whilst legislating in this area, the government could helpfully also make other amendments to ensure that FA 1986 is fully aligned with the way that the ADS market operates in practice. It is hoped that HMRC will be open to considering this as part of the consultation.

Bearer instrument duty

The draft legislation also repeals the charge to stamp duty, at a rate of 1.5% (or 0.2% in some limited circumstances), on the issuance of bearer instruments in the UK, or outside the UK by or on behalf of a UK company, set out in FA 1999 Sch 15 para 1. This repeal is not surprising since HMRC had also accepted that the 1.5% charge on issuances of bearer shares was incompatible with the Capital Duties Directive.

The practical significance of bearer instrument duty has been diminished since 2015, when, with the aim of promoting transparency, s 779 of the Companies Act 2006 was amended (by the Small Business, Enterprise and Employment Act 2015) such that UK companies could no longer issue share warrants to bearer (and a transitional period was introduced for the cancellation and surrender of existing bearer shares). We have certainly come a long way since the late 1990s, when, in the days before the CJEU case law on the Capital Duties Directive, non-sterling bearer shares provided the means to mitigate the 1.5% charge on placing shares into a depositary receipt system or clearance service.

Consultation

A consultation on the draft legislation runs until 12 October 2023.

This follows a separate consultation earlier in the year on the modernisation of stamp taxes on shares (including on the proposal to merge stamp duty and SDRT into a single, combined tax), responses to which are currently being digested by HMRC. The 1.5% charge was outside the scope of that consultation (a separate, follow-up consultation on these was envisaged) – but it is clear that the creation of a single combined stamp tax would involve further significant changes to the legislation in this area.

The title of this article is '1.5% stamp tax charge: continuity or change?' Perhaps that should have been 'continuity *of* change'? ■

For the draft legislation, see bit.ly/stamptaxesonshares.

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- UK companies listing in the US (J Cooklin & D Wilson, 13.3.14)
- Brexit, Air Berlin and the 1.5% stamp duty charge: reasons to be cheerful (J Kemp, 16.1.18).