Analysis

The stamp taxes on shares modernisation: modern enough?

Speed read

HMRC's consultation on the modernisation of stamp taxes on shares sets the scene for the introduction of a consolidated single stamp tax, which together with its proposed simplified territorial scope and modern self-reporting portal, represents a fundamental (and largely welcome) change to the UK tax system. However, a number of existing issues appear to remain unresolved, such as a lack of clarity over 'stock' for the purposes of acquisition relief, the availability of group relief where foreign entities are involved, and what is 'reasonably comparable' for the purposes of the loan capital exemption. The proposed new regime also raises some fresh practical issues, including some uncertainty where contingent and variable consideration is involved and additional compliance burden for small transactions.

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Given the ageing and labyrinthine tapestry of today's stamp duty and SDRT legislation, it is unsurprising that feedback on HMRC's consultation on the modernisation of stamp taxes on shares has been largely supportive (see, for example, 'Modernising stamp duty: are we nearly there yet?' (Emily Szasz and John Tolman), *Tax Journal*, 26 May 2023). Indeed, this ambitious project, proposing that stamp duty and SDRT are consolidated into a single tax, with a simplified territorial scope and modern self-reporting portal, contains much to applaud. However, for a project in the works since the Office of Tax Simplification announced a review of stamp duty on paper transactions in December 2016, practitioners might wonder whether the proposals go far enough, and if they achieve HMRC's laudable aim of creating a truly modern, efficient and equitable system of stamp taxation.

In this article – pending release of HMRC's response to the consultation – we look a bit closer at what appear to be some missed opportunities and remaining open questions, and some issues in practice that may arise with the new regime, if the consultation results in (and only in) the changes contemplated thus far.

Missed opportunities?

There are several issues and uncertainties with the existing stamp taxes on shares regime that the consultation overlooks, rejects, or avoids addressing. The summary that follows is by no means comprehensive but it identifies certain gaps, anachronisms and ambiguities that we see arise in practice and that would remain unresolved.

Happily, one issue that the consultation left to be dealt with separately is now being considered, namely the status of the higher rate 1.5% stamp duty and SDRT charges. (For further details, see '1.5% stamp tax charge: continuity or change?' (David Wilson and Jack Jones), *Tax Journal*, 29 September 2023.)

Acquisition relief: interaction with third-party debt

The consultation proposes to retain 'acquisition relief' in FA 1986 s 77, but without any changes other than to clarify certain undefined case law concepts. Broadly speaking, acquisition relief applies on the insertion of a new holding company in a group by way of a share for share exchange.

In not proposing to make substantive changes, there is a risk that HMRC will maintain its position that a qualifying share for share exchange also requires an exchange of 'stock'. Although HMRC have sought (in their *Stamp Taxes on Shares Manual* at STSM042415) to elaborate on what it understands by this term – to include debt instruments such as bonds and loan notes (although not generally including mortgages, bank loans and overdrafts) that provide a company's longer-term capital financing – the concept remains broad and not always certain. It can also create significant practical challenges. To satisfy HMRC's requirements, an in-scope debt instrument would need to be acquired and reissued as part of the exchange, or eliminated or otherwise removed beforehand. This may not be feasible, especially for debt instruments held by a third party. It is far from clear that including stock of this nature is something the original legislation intended, and the complexities and impracticalities would be ripe for addressing in modernisation.

Ambiguity of this kind [in the case of group relief's application to non-UK entities] sits uncomfortably in today's world of international holding structures

Group relief: beware partnerships and foreign entities

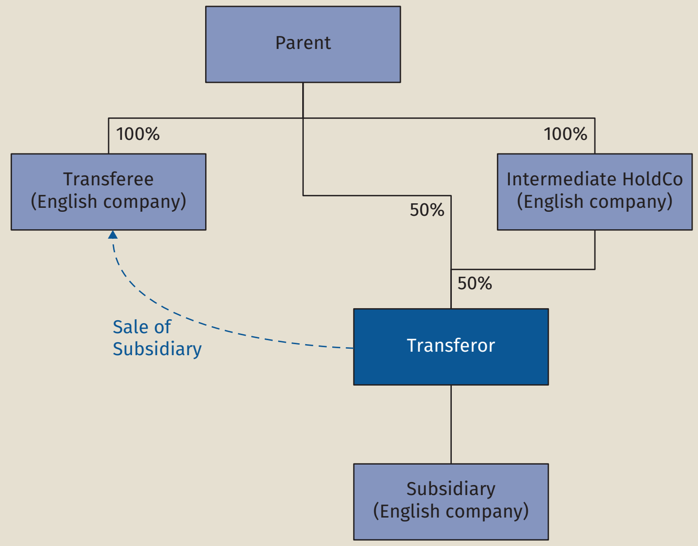
One of the least-modern aspects of the existing regime can be seen in the context of group relief under FA 1930 s 42 – which the consultation generally proposes to preserve without amendment. In particular, the requirements for the transferor and transferee to be 'bodies corporate', and for the necessary group relationship to be traced through bodies corporate that issue 'ordinary share capital', are increasingly outdated and can have seemingly arbitrary consequences.

Take, for example, the figure (above right), which contemplates a transfer of the shares in an English company (Subsidiary) from one entity (Transferor) to another English company (Transferee) that are both wholly owned by the same parent company.

Absent any other disqualifying features, if Transferor is an English company, group relief will be available. However, if Transferor were to take another legal form, relief could be uncertain or denied:

- Looking at UK vehicles, group relief would not be available if Transferor was an English (or Scottish) limited or general partnership (because they are not bodies corporate and they do not issue ordinary share capital); nor would relief be available if Transferor was a limited liability partnership (because LLPs also do not issue ordinary share capital). Excluding relief in these situations is hard to explain.
- In the case of non-UK entities, the question of body corporate status or the existence of ordinary share capital may be uncertain even before grappling with the implications. HMRC has published a list of entities that it considers are bodies corporate (see HMRC's *Stamp Taxes on Shares Manual* at STSM042260), but the list is not comprehensive and a complex analysis is required for entities not on it, especially if those entities do not closely follow the model of an English company or partnership. Ambiguity of this kind sits uncomfortably in today's world of international holding structures and also might have been a natural target for correction in a modernisation exercise.

Group relief involving partnerships or foreign entities



Loan capital exemption: what is 'reasonably comparable'?

The proposed base for the new tax is non-government equity in UK incorporated companies, including stocks and bonds with equity-like features. It is proposed that the relevant equity-like features will be defined along similar lines to those used for the purposes of the 'loan capital exemption', as set out in FA 1986 ss 79(5) and 79(6). By and large these features are well understood, but one which can create some uncertainty in practice asks whether the loan capital carries a right on repayment to an amount which exceeds the nominal amount of the capital and is not 'reasonably comparable with what is generally repayable (in respect of a similar nominal amount of capital) under the terms of issue of loan capital listed in the Official List of The [London] Stock Exchange'.

Taking the test at face value it is necessary to identify similar amounts of London listed bonds to determine whether repayment conditions are reasonably comparable. This raises various questions: What is a 'similar' nominal amount? What does it mean to be 'generally repayable'? When are terms 'reasonably comparable'?

The corporation tax distributions code contains a test at CTA 2010 s 1015(3) asking whether securities are issued 'in terms which are reasonably comparable with the terms of issue of securities listed on a recognised stock exchange', and HMRC's *Corporate Finance Manual* (at CFM37870) says that 'genuine instruments that are issued commercially' are expected to be so comparable. It would be helpful for the new stamp taxes regime to reflect this kind of practical approach, but it is not clear from the consultation document whether this kind of solution is contemplated.

Mergers by operation of law

As the consultation acknowledges, it has been suggested that the government should clarify whether securities moving by operation of law are within the scope of stamp duty and SDRT. The question would arise on a transfer of English company shares in an EU cross-border merger. It also would arise with mergers in jurisdictions like the US, and in other overseas corporate operations, like partial demergers, that involve the movement of shares by way of 'universal transfer' or 'universal succession', without the need to comply with specific transfer formalities.

Although the consultation contains a proposal for legislation to '[reflect] current market practice and case law', the idea of taking transfers by operation of law out of scope was rejected. Given the diverse array of transactions across the world that can result in transfers by operation of law this is perhaps understandable, but equally an attempt to reflect market practice and case law is unlikely to be a solution. We see two reasons for this. First, clearances in this area often remain advisable, notwithstanding the state of current market practice and case law. Second, the principles considered in market practice and case law in the context of the current regime may not track easily into the new regime, noting that the charging point for the new regime will be entry into an agreement rather than execution of an instrument of transfer.

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Some new practical issues

As well as carrying over certain issues from the current regime, the proposed new regime also raises some fresh practical issues. Without aiming to be comprehensive, two examples that we expect to see are discussed below.

Contingent and variable consideration

One of the generally welcome proposals relates to the treatment of fixed but contingent consideration and uncertain or variable consideration. The current stamp duty treatment is not ideal. In particular, consideration that is contingent or variable but subject to a stated upper limit (such as an earn-out subject to a cap) is subject to duty up front on the maximum amount. This could leave a share purchaser with a stamp duty bill that is not aligned with the underlying consideration actually paid, and a mismatch in timing between the payment of the stamp duty and the quantification and payment of the consideration.

The consultation proposes to solve for this by allowing the use of reasonable estimates, and adjustments once the contingency is known or finalised. It also contemplates a deferral of payment in some cases (although not for more than two years).

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While the proposed approach should ultimately result more often in the 'right' outcome, it will introduce incremental uncertainty as to the final amount and timing of the stamp tax. The trade-off for a more logical outcome in these cases will accordingly be a lack of clarity when factoring stamp duty into target bid values and into post-transaction cash flows. A further knock-on consequence, in transactions where the purchaser and vendor agree to split the stamp duty cost (which although unusual in the UK market is not uncommon with US counterparties), is that machinery may need to be put in place in the transaction documentation to allow for post-closing payments and adjustments between the parties to reflect extra payments and refunds of tax over time.

Small transactions

Unnecessary time and compliance cost is a key issue that modernisation ought to address – particularly in relation to transactions that do not result in any material underlying tax. We share the widely held disappointment that the current stamp duty exemption for share purchases where the consideration is less than £1,000 is proposed to be eliminated rather than maintained or even increased. This means that the need to pay stamp duty before updating a company's share register will survive for even the smallest of transactions. It is to be hoped that the new online self-reporting system is so easy to use and quick to generate transaction reference numbers that remitting nominal amounts of tax and waiting for a response is not a disproportionate burden for transactions that previously would have been out of scope.

Although not a big-ticket item, another potentially adverse feature with small transactions is the preference for adopting the SDRT approach to fixed penalties for late notification of a stamp tax charge. Specifically, the proposal that purchasers be liable to a fixed penalty of £100 on any late notification, however small the underlying liability. This can have a highly disproportionate outcome with multiple low value transfers under a single transaction (for example, on the acquisition of a company with a minority, but broad employee-based ownership). Imagine a transaction under which a transferor acquires shares from 50 transferees, for £10,000 each. Each transfer would need to be reported, and if the transferor is late in notifying, the aggregate fixed penalties of £5,000 would be double the amount of the tax. ■

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