Examining proposed changes to share-for-share tax relief

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Tax analysis: Michael Quinlan, barrister at Temple Tax Chambers who specialises in transaction taxes involving real estate and securities, examines the potential amendments to sections 77 of the Finance Act 1986 (FA 1986).

Original news

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The government has tabled a new clause for Finance Bill 2016 introducing a change to the rules on stamp duty share-for-share relief with effect from 29 June 2016. This means that no relief will be available where arrangements are in place, at the time the share-for-share exchange instrument is executed, that would allow any person alone or persons together to gain control of the acquiring company.

What is the context of this proposed amendment?

FA 1986, s 77 provides relief from stamp duty at 0.5% when a new top company (the acquiring company) is inserted above an existing company (the target company) by way of a share-for-share exchange. The conditions of relief require that the whole of the existing share capital (and any other stock) of the target company is transferred to the new company in exchange for the issue of shares to the former shareholders of the target company, such that their holdings in the new company reflect, or mirror, as nearly as may be their former shareholding in the target. The acquisition must be for bona fide commercial reasons and not form part of an arrangement of which the main purpose, or one of the main purposes, is the avoidance of certain taxes, including stamp duty and stamp duty reserve tax (SDRT). The purpose of the provision is to relieve the insertion of a new top company from stamp duty where there is no change in economic ownership, since the share ownership in the target company, which becomes a subsidiary will be reflected in that of the acquiring company—its new parent. The government has now introduced a measure intended to tighten the conditions for relief.

What does the new change to stamp duty share-for-share relief in FA 1986, s 77 do?

If the new clause is enacted in its present form, the amendments to FA 1986, s 77 and the introduction of new FA 1986, s 77A prevent the application of share-for-share relief where arrangements are in place to secure a change of control of the acquiring company (disqualifying arrangements)—that is, a change of control of the new top company, otherwise than pursuant to ‘relevant merger arrangements’ as defined in FA 1986, s 77A. Relevant merger arrangements are those where the new company is to acquire a second company after it has acquired the original target and, ignoring the shares in the new company that will, at the time of the merger, have been issued as consideration for the original target company, the conditions in FA 1986, s 77(3) would be met.

Why was this new condition added without notice or consultation?

The new change of control condition has been introduced in respect of stock transfers executed on and from 29 June 2016 to counter a perceived threat to the tax base. I assume that, as with similar measures in the past, it has been introduced without public notice to prevent exploitation of an opportunity that, with notice, would have been made apparent to those taxpayers who were not otherwise aware of it.

What mischief does the government intend to prevent by adding this further condition?

I understand HMRC have identified transactions where share-for-share relief is claimed in the context of a takeover. Following the changes to the Companies Act 2006 in 2015, HMRC made clear that all UK mergers and takeovers should be subject to stamp duty. However, if the acquiring company that benefits from share-for-share relief is established outside the UK (in Jersey, for example, where there is no local duty or tax payable on the purchase of shares and those shares can still be listed, traded and settled in London without stamp duty or SDRT), it can be taken out of the scope of UK stamp tax altogether.

The new clause has been prompted by such arrangements and has been introduced to curtail lengthy debate about whether the present anti-avoidance measure in FA 1986, s 77(3)(c) is triggered—it being arguable, according to the facts, whether an arrangement has avoidance of stamp duty or SDRT as one of its main purposes. Purpose tests can be problematic with transaction taxes as the predominant purposes for acquiring assets ordinarily concern the commercial benefits of that acquisition for the acquirer, whereas tax advantages, albeit important financially as they may mitigate acquisition costs, are peripheral. This is the reason why there are both change of control and motive based anti-avoidance tests for stamp duty land tax (SDLT) group relief.

It is understood that there is no present intention to introduce a similar measure for reconstruction relief in FA 1986, s 75 as, so far as HMRC are aware, that provision is not being exploited in a manner that reflects their recent experience with FA 1986, s 77.

Following this change, what types of structuring would be at risk or no longer be possible?

Any structure where plans to dispose of substantial shareholdings in the new parent undertaking are more than merely speculative and aspirational (and therefore implemented in circumstances that are likely to involve a change of control of the acquiring company (broadly defined by reference to section 1124 of the Corporation Tax Act 2010)) are not eligible for relief under FA 1986, s 77 other than a future share-for-share acquisition by the new company of a third company which meets the stringent conditions for a relevant merger arrangement. It is no longer possible to couple share-for-share relief with a disposal of the new parent company.

HMRC have, however, indicated in the Tax Information and Impact Note for the new clause that the changes are not intended to have an adverse impact on initial public offerings (IPOs). I understand that guidance will be forthcoming to the effect that:

- an underwriter's obligation to take over allotments will not, of itself, be viewed as a disqualifying arrangement—it being a contingent contractual provision that is needed to manage commercial risk rather than a consequence sought or desired by the principals or promoters of the IPO, and
- the subscriber shares issued on formation of the acquiring company prior to the transfer of shares in the target will be treated as consideration for the target company and disregarded in the event of a relevant merger under FA 1986, s 77A(4)(c)(ii)

Do you foresee any collateral damage?

On the one hand, these provisions do not prevent the application of share-for-share relief followed by a takeover of the acquiring company by an unidentified buyer at some as yet unascertained point in the future—they mean simply that you cannot utilise the relief in the context of a takeover or other substantial disposal of shares in that company. On the other hand, there is a risk that inserting a new UK top company to clean up a corporate group followed in the near term by a takeover by another UK company could result in stamp duty charges on both transactions. The former now needs to be a strategic decision, independent of the latter.

Given that 'arrangements' do not need to be legally enforceable or in writing, what guidance is available on when an arrangement to transfer control of the acquiring company is in existence?

There is case law on arrangements generally for the purposes of stamp duty group relief and the definition of arrangements in FA 1986, s 77A as including 'any agreement, understanding or scheme (whether or not legally enforceable)' is similar to the corresponding definition for disqualifying arrangements for group relief from SDLT in Schedule 7 to the Finance Act 2003. HMRC guidance is necessarily principled rather than fact specific (although some examples are provided) and is to be found in the Stamp Taxes on Shares Manual at STSM042280 and the Stamp Duty Land Tax Manual from SDLTM23220. Relevant commentary can be found in Sergeant and Sims on Stamp Taxes in Parts A14.10 (stamp duty) and AA7.2 (SDLT). Guidance on the application of FA 1986, s 77A is expected in due course.

Interviewed by Diana Bentley.

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