Temple tax chambers

SDRT Risk in Covid-19 Lockdown – Letters of Direction

By Michael Quinlan

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Background

Stamp duty applies to documents, individually referred to in the legislation as an "instrument", used to transfer UK securities, typically shares, on a sale (being essentially a transfer for money, shares, unit trust units or debt)[1]. Stamp duty reserve tax ("SDRT") applies to the agreement for that transfer. The rate is the same, 0.5%, but the incidence of SDRT is different, encompassing not only electronic or book entry transfers where there is no instrument of transfer (which it was introduced to do) but also where the "price" is anything in money or money's worth, i.e., not just a stamp duty "sale".

To prevent double charging, pick up the stamp duty exemptions and narrow the scope of SDRT so that it aligns with stamp duty, SDRT is cancelled if an "instrument" is "executed" in pursuance of the agreement and transfers the shares, and is either a) duly stamped; or b) not chargeable, or otherwise required to be stamped as exempt (certain exemptions require an adjudication stamp). Letters of direction are created specifically to take legitimate advantage of this cancellation or "franking" mechanism where transfers are for money's worth but are not "on sale" in the circumstances outlined under "Letters of Direction", below.

Stamp duty is ordinarily denoted by a die impressed on the original document by HMRC. In response to government guidelines for social distancing and remote working in the face of the pandemic, HMRC has stated that it will accept electronic copies of documents by email and e-signatures while coronavirus (COVID-19) measures are in place, rather than hard copies upon which a duty stamp would ordinarily be impressed, a letter from HMRC taking the place of a die stamp to demonstrate duty has been paid or an exemption adjudicated, as the case may be.

For those of us whose university days were before smartphones were invented and FaceTime was in the student union bar, a useful refresher on the utility and efficacy of e-signatures, executing documents in counterpart and the advisability of "wet ink" signatures on hard copies in certain situations (which mentions stamp duty in passing), can be found in a Practice Note on the Law Society's website.[2]

[1] Stamp Act 1891, ss. 55 to 57; Finance Act 1999, Sch.13

[2] Registration is free; see: https://www.lawsociety.org.uk/support-services/advice/practice-notes/execution-of-a-document-using-an-electronic-signature/#top

The issue

There may be a temptation in this environment to move to electronic documents and e-signatures more broadly.

A sensible 21st Century attitude to commerce, surely?

Can you read the new guidance in this way?

What are the risks?

What is an "instrument" and when is it "executed"?

The stamp duty definitions seem promising at a glance. The expression "instrument" includes every written document[3] and the Interpretation Act[4] defines "writing", unless the contrary intention appears, so as to include typing, printing, lithography, photography and other modes of representing or reproducing words in a visible form, and expressions referring to writing are construed accordingly. With instruments not under seal, "executed" and "execution" mean simply signed and signature[5]. Emails may suffice, even with certain documents that require statutory formality such as the disposition of an equitable interest[6].

The rub, of course, is the context. The writing contemplated by the stamp duty legislation must be such that one can place it in a heavy, cast iron machine and bring an inked die down on it with sufficient force to impress the appropriate stamp.

I don't have to ask the folk at HMRC to stick my laptop in there: I can print a copy!

Sounds like a plan, but … the instruments with which stamp duty is concerned are those that create legal rights and obligations: in this case an effective transfer of ownership, legal or beneficial, of the shares. This can be seen in the charging provisions[7], the provisions for duplicates and counterparts[8] and in the case law[9].

If instruments capable of being physically stamped are to have the requisite effect when executed, we are talking about hard copy documents.

The legal transfer of shares that are dematerialised in the CREST settlement system does not require a stock transfer form. Nor does the transfer of beneficial ownership in the books of a custodian. Authenticated electronic messaging will suffice.

However, a print out of an electronic document, duly e-signed by the parties and valid in that virtual form under the Electronic Communications Act or the EU's QES regime[10] will not be

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[3] Stamp Act 1891, s. 122
[4] Interpretation Act 1978, s.5 and Sch.1
[5] Stamp Act 1891, s.122
[6] See the cases cited in Part 4.2 of the Law Society's Practice Note, Fn 2, above; Law of Property Act 1925, s.53(1)(c)
[7] See e.g., Finance Act 1999, Sch.13, para 1
[8] Finance Act 1999, Sch.13, para 19
[9] See Sergeant and Sims on Stamp Taxes, Butterworths loose-leaf, part A3.1 and the cases there cited.
[10] See the Law Society's Practice Note, Fn 2, above

effective as a transfer because the transfer has already happened electronically. The copy has no work to do other than evidence the electronic transaction. There is a proximate risk that it will not be an instrument of transfer that cancels SDRT.

Reform is on its way but (like an end to lockdown) we're not there yet

In 2017, the Office of Tax Simplification recommend that stamp duty be modernised[11] but no action has as yet been taken in this regard.

Regulations were made last year that amend the legislation relating to stamp duty so as to enable HMRC to denote duty other than by impressed stamps[12], but the method of doing so has been the subject of lengthy discussions with stakeholders and has yet to be resolved.

The long term objective is to digitise the stamp mechanism in line with the HMRC's objective of digitising tax. However as stamp duty is relatively small as a revenue base, it is not currently high on the list of HMRC priorities, with resources being directed to other tax systems and EU Exit work. The legislative changes required to digitise stamp duty would be complex and overall best tackled on a longer term basis[13].

Letters of Direction

Properly drafted, such letters are transfers of beneficial ownership. The transferor directs its custodian or nominee to hold the beneficial interest in the shares for the transferee immediately, and to transfer the shares to the transferee's account such that the transfer of legal title, in CREST for example, involves no change of beneficial ownership.

Letters of direction are used to enable a claim to be made for a stamp duty exemption, e.g., group relief, where there is no corresponding relief from SDRT. Instruments entitled to such exemptions are not duly stamped without adjudication, have to be produced to HMRC for that purpose and are therefore within the guidance[14].

They are also used when the quid pro quo for the transfer is (or may be construed as) money's worth but is not of a kind that characterises the transaction as a sale for stamp duty purposes. The SDRT is cancelled and there is no stamp duty on the document. The letter does not have to be produced to HMRC. It is simply not chargeable.

The drafting and timing of effective letters of direction is beyond the scope of this article. Suffice to say that they are widely used for share transfers into, out of and between civil law contractual funds in, e.g., France, Luxembourg, the Netherlands and Switzerland for contractual units, and life companies in return for or in satisfaction of rights under policies.

For these sectors, timely execution of effective letters of direction is part of their operational tax risk management.

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[11] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/625338/OTS_stamp_duty_on_paper_documents_web.pdf

[12] The Stamp Duty (Method of Denoting Duty) Regulations 2019, SI 2019/719

[13] Note of meeting on Stamp Duty Presses, 25 April 2019.

[14] As to which see HMRC guidance of 27 March: https://www.gov.uk/guidance/stamp-duty-reliefs-and-exemptions-on-paper-shares.

In this context they may be signed by custodians, investment advisers or asset managers, as well as the transferor and transferee or their authorised agents, commonly with two signatures under each signature block. It would clearly be of considerable benefit to use electronic documents and e-signatures, generally and particularly in the current circumstances.

HMRCs' response to coronavirus (Covid-19)

The Covid-19 lockdown came on 23 March 2020. HMRC Stamp Taxes acted quickly and sensibly to accommodate self-isolating and remote working in line with government policy, for their own staff and taxpayers. Guidance was provided on 25 March, and has been supplemented, to the effect that, rather than post hard originals for stamping, email should be used to submit documents electronically. For this purpose, an electronic copy (for example, a scanned PDF) of the relevant instrument of transfer should be submitted after payment of any stamp duty due and HMRC will, if satisfied all is in order, send a letter stating that the document should be considered duly stamped for the purpose of filing, registration and penalties.

The guidance states that "HMRC will accept e-signatures while coronavirus (COVID-19) measures are in place".

HMRC have said:

> For all Stamp Duty cases that are dealt with by HMRC under the temporary processes there will be the opportunity to present the original documents to us for stamping once Covid-19 measures end and we are able to physically stamp documents again. The confirmation letter that HMRC have sent in place of stamping the document must be sent to us alongside the original document for stamping to ensure that no late notification penalties are charged.[15]

These measures may be within the administrative discretion of HMRC in extraordinary circumstances, and are in any event generally welcome in the face of a national crisis. If you have paid the right amount of duty or legitimately claimed an exemption in line with the guidance, it beggars belief that HMRC would subsequently challenge the outcome.

But what if you self-assess that an instrument of transfer is not chargeable in circumstances where the existence of that instrument cancels SDRT otherwise payable at 0.5% of the consideration given for the agreement to transfer?

What if the potential SDRT charge is substantial?

Can you rely on guidance about the stamping or adjudication of documents by HMRC, driven by public administrative imperative, in relation to instruments that do not need to be provided to HMRC for that purpose?

Analysis

The cancellation mechanism in section 92 of the Finance Act 1986 requires two things. First, under section 92(1A), that an instrument is (or instruments are) executed in pursuance of the

[15] Note to Working Together Shares Group, 16 April 2020

agreement (i.e., the agreement chargeable to SDRT) and the instrument effects the transfer. The second condition, in section 92(1B)(a), is that the instrument is either i) duly stamped or ii) not chargeable, or otherwise required to be stamped. Section 92 (1B) clearly requires a physical, hard copy instrument, i.e., one to which a stamp can be affixed if chargeable. I think that this is the case whether the instrument is chargeable or not, as "instrument" in the preamble in subsection (1B)(a) must have the same meaning in both of sub paragraphs (i) and (ii) that follow.

All one might have otherwise is a mere print out of a document that is wholly electronic, admissible and binding under section 7 of the Electronic Communications Act 2000 and English common law, but not an instrument of transfer within the meaning of section 92(1B)(a)(ii).

To my mind, the prudent view is that the temporary HMRC practice of accepting electronic copies of documents and e-signatures is confined to the administration of stamp duty where documents would otherwise have to be posted and physically stamped, and says nothing about the efficacy of e-commerce for stamp duty purposes generally.

My particular concern relates to letters of direction for high value transactions (for an insurance policy, into a contractual fund and the like). My sense is that nothing has changed with these: electronic documentation and e-signatures are authorised solely for the purpose of enabling HMRC to administer stamp duty in the current national emergency, such that, if you are self-assessing, you need hard copy originals with wet ink signatures, albeit that they may be signed in different places in counterpart.

Conclusion

I suspect that HMRC may take a relatively benign approach to all of this when the current crisis is over. However, they are, of course, confined by the legislation like the rest of us and the scope of their discretion in relation to the administration of tax is limited[16].

It therefore seems that the prudent course with letters of direction is to continue to have a physical original document signed by or on behalf of the transferor, sent to the counter-parties as a scan, printed and signed by them, scanned and then returned by email, such that the hard copy counterpart originals, when collated subsequently by post, courier or DX, form a single physical instrument, signed (with "wet ink" in the terminology of the Law Society's Practice Note) in hard copy. That composite instrument can then be produced to HMRC on enquiry.

Failing that, an absolute minimum in view of section 53(1)(c) of the law of Property Act 1925 would appear to be for at least the transferor or their appropriately appointed agent to sign the physical original letter in ink. Whether counter-parties or custodians can sign electronically depends on the governing law and jurisdiction in which they are established.

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[16] See, e.g., *Vestey v HMRC* [1980] AC 1170 at 1172.