

United Kingdom Stamp Duty Reserve Tax: Clearance Services

8 October 2009

On 1 October 2009 the European Court of Justice (ECJ) handed down a decision in the case of *HSBC Holdings PLC and Vidacos Nominees Limited v HMRC* that concerned UK Stamp Duty Reserve Tax (SDRT). The ECJ held that it is not lawful for the UK to impose a 1.5% SDRT charge when securities in a UK company are issued into a clearing system within the EU. This may trigger a number of claims for refunds of overpaid SDRT.

SDRT is imposed on transfers on certain securities in companies incorporated in the UK at the rate of 0.5%. In addition, where such securities are issued or transferred into a clearing service, SDRT is applied at a rate of 1.5%, with no additional SDRT (or stamp duty) on transfers subsequently taking place within that clearing system. A similar 1.5% SDRT charge is imposed when securities in a UK company are transferred into an issuer of depositary receipts (such as ADRs). The SDRT charge is legally imposed upon the clearing system (or the issuer of depositary receipts). However, in practice the company that is issuing the securities will normally bear the cost of the SDRT.

Member states of the EU generally retain autonomy over tax matters, although there are a number of areas in which EU law will take precedence. Under the EU Capital Duties Directive, there is a prohibition on indirect taxes raised on an issue of securities, although generally not on transfers of securities.

The Disputed SDRT Charge

In connection with a takeover of a French company, HSBC issued shares into Sicovam, a clearing service for the Paris Stock Exchange. SDRT was charged at 1.5% on this issue. HSBC challenged this charge and the English courts referred the issue to the ECJ.

The ECJ held that the imposition of the charge on shares issued into the clearing system was contrary to the Capital Duty Directive. None of the relevant exceptions applied to the present case. The UK government had argued that the 1.5% was in effect a “season ticket” being charged in lieu of the normal SDRT charge on subsequent transfers of the securities, since further transfers within the clearing system did not attract the normal SDRT charge. Had this argument succeeded, the SDRT charge may have been valid, given the lawfulness of imposing SDRT on transfers of shares, as opposed to issues of shares. However, the ECJ rejected the argument. It deemed that the 1.5% charge could not be in lieu of future SDRT charges on transfers since, for example, the frequency or value of subsequent transfers was not then known, nor was the identity of any parties to future transfers known.

What Does This Mean for UK Companies?

HMRC has already responded to the ECJ decision by announcing that it will no longer impose the SDRT charge on the specific scenario covered by the case, namely the issue of shares into a clearing system within the EU. HMRC has also indicated that it is considering how to introduce legislation to ensure that companies “bear their fair share of tax” in respect of movements of shares into and within clearing systems. Furthermore, anti-avoidance legislation is to be introduced to prevent the routing of securities intended for the U.S. market through EU clearing services.

A number of UK companies have borne the SDRT on issues into clearing systems and also the equivalent charge on issues of securities to a depositary receipt. In principle, there appears to be no reason why the ECJ decision would not apply to SDRT imposed on issues into an EU depositary receipt. The Capital Duties Directive does not specify any territorial scope. Hence it is possible that the same principles may be applied to prevent the imposition of SDRT on issues of shares into a non-EU clearing system or depositary receipt, including in particular ADRs. This outcome is not certain, however, since the purpose of the Directive is to promote the free movement of capital within the EU.

It will be interesting to see how HMRC attempts to legislate for this issue, and what challenges are brought by UK taxpayers with respect to similar scenarios. It remains to be seen whether further litigation will address the position for non-EU depositary receipts and clearing systems. Companies that have, within the last six years, borne SDRT on issues of shares into a clearing system or depositary receipt may wish to consider the making of a claim for a refund. There may also be avenues available to attempt to recover such SDRT paid more than six years ago.

HMRC’s proposed legislation to address the ECJ decision and, in particular, the scope of such legislation and the anti-avoidance rules, are now anticipated with interest.

For more information about the issues discussed in this Tax LawFlash, please contact your Morgan Lewis attorney or the contact listed below.

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