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STAMP DUTY: SOME IMPLICATIONS OF ADOPTING A CORPORATE STRUCTURE

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To anyone who may think that fiscal neutrality as between different possible forms of business structure should be an objective of the tax system, there is a glaring inconsistency in the Stamp Duty regime. This lies in the significant difference between the maximum rate of duty payable on transfers of property other than shares, viz 4%, and the fixed duty on sales of shares at 0.5%. The former has of course been steadily rising since July 1997 and is commonly thought set to increase still further, certainly under a continuing Labour Government. By contrast, the rate payable on shares does not seem vulnerable to future increase and indeed there has been pressure on the Chancellor to reduce (if not to abolish) it, in the interests of the competitiveness of UK plc. Therefore, if stamp duty were the only consideration in the world, a person might be encouraged to hold all his property in a company, or perhaps each parcel of real property in a separate company, so that on a prospective sale the shares could be offered for sale at some price incentive to the purchaser. This is a real option in practice, though not one without its difficulties (especially following FA 2000), which is the subject of this article.

Of course stamp duty must always be regarded in the context of other taxes. Indeed, in relation to capital gains tax, the new effective 10% rate of tax after taper relief will be achieved with a disposal on or after 6th April 2002 of "business assets" as defined under the FA 2000 regime held since 5th April 1998 (assuming that the assets were also defined "business assets" from 6th April 1998 to 5th April 2000). If not long after 2002 the marginal rate of stamp duty has

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been increased to say 7%, it may well be found in any individual case that 10% of the gain is less than 7% of the value. That comparison could of itself justify a restructuring of arrangements, accepting the capital gains tax cost in order to mitigate stamp duty. In the context of capital gains tax, the traditional disadvantage of holding appreciating assets within a company as against an unincorporated structure is of course the double charge to capital gains tax. Non-corporate shareholders now benefit from taper relief (and indeed the capital gains tax-free uplift to market value on death), whereas within a company indexation allowance continues. The sums must be done in each case to quantify the practical effect of the double charge; they may lead to surprising results.

For inheritance tax purposes, there is no disincentive to (and there maybe an advantage of) holding within a company assets which constitute relevant business property now that 100% business property relief is given to minority shareholdings, however small, in an unquoted trading company. Incorporation is unlikely to make much fiscal difference with assets which are not themselves relevant business property (except, significantly, in a case where the assets e.g. let property are owned by a trading company the shares in which are relevant business property, although the 1999 Special Commissioners' decision in *Farmer & Giles (Farmer's Executors) v CIR* [1999] SSCD 321 (SpC 216) indicates that this advantage may also be achieved within an unincorporated business). That said, there could well be advantages in adopting a corporate structure for shares that do not attract business property relief, insofar as for valuation purposes fragmentation of shareholdings within a family (other than husband or wife where the related property rules operate under section 162 IHTA 1984) will diminish overall value. There are also obvious commercial considerations in terms of the protection of the corporate veil, but also transparency to the outside world in terms of publication of accounts and additional compliance costs.

The above remarks are made by way of introduction. The subject of capital gains tax is considered in more detail below. The initial issue is whether or not it makes sense to incorporate an existing business.

Transfer to the Company: Assets Other Than Land

The first hurdle is that of course ad valorem stamp duty may be payable by the company on transferring the property in the first place, unless perhaps the transfer can be structured as a gift. Quite apart from commercial considerations of holding property within a company, there will also be capital gains tax to consider on the transfer (see below). Stamp duty will be avoided if there is a gift rather than a sale to the company, when the transfer document can be certified

Category L under the 1987 Exempt Instruments Regulations. That is an obvious attraction.

Transfer to the Company: Land

The enactment of section 119 FA 2000 provokes considerable rethinking where it is an interest in land which is to be transferred to a company. In circumstances where (as will almost inevitably be the case) the transferor is connected with the company within the meaning of section 839 TA 1988, there will be an ad valorem stamp duty charge even on a gift. This means that the taxpayer faces the choice between paying the stamp duty on a gift of the land to the company now (perhaps in the expectation that not only will the value of land increase, but so too will the applicable rates of stamp duty) and allowing the transfer to "rest in contract".

The Section 120 Exceptions to Section 119

Representations on clause 118 FB 2000 (now section 119 FA 2000) had focused on the inequity of the rule applying where a person had made a gift of land to a company with which he was connected since 28th March 2000. Although, on 14th July 2000 the Government announced changes to the measures in response to representations, those changes do not, alas, help that simple (and very common) case, discussed below. Section 120 disapplies the provisions of section 119 from the following categories of transfer (only):

- transfers to or from a nominee or bare trustee;
- transfers out of a settlement which would qualify for Category F certification under the 1987 Exempt Instruments Regulations;
- transfers to an independent corporate trustee; and
- transfers forming part of a distribution, including distributions on liquidation, where the asset is acquired by the company under a "duly stamped" instrument.

Section 120 applies to documents executed after 28th July 2000. In cases where documents within the disapplied categories had been stamped between 28th March 2000 and before 29th July 2000, a claim can be made for repayment of any excess duty, though it must be made before 1st April 2001.

In section 120, it is the fourth category mentioned above which is especially important. Otherwise, ad valorem stamp duty would have been payable on the transfer by a company to a corporate controlling shareholder of an interest in land by way of a dividend in specie or as a distribution in a winding up (neither of which would before 28th March 2000 have attracted stamp duty, either through certification under Category L or Category I of the 1987 Exempt Instruments Regulations or, if a liability was secured on the land, in a case where advantage could not be taken of the intra-group exemption under section 42 FA 1930, on the grounds that there was no 75% shareholding connection. Ordinarily the section 42 relief would not help with a liquidation because that section requires satisfaction of the beneficial ownership test and a company loses beneficial ownership of its assets once it goes into liquidation. This problem can be circumvented by having the company first sell its assets to its holding company with the consideration left outstanding as a debt to be paid off in the winding up. This structure should be possible even after the FA 2000 changes to section 42).

The Scope of Section 119

The fundamental trap in section 119 therefore remains. The section applies where either the person transferring an estate or interest in land is connected with the company transferee **or** some or all of the consideration consists of the issue or the transfer of shares in a company with which the transferor is connected. That is, even in the case of a gift of land from a person to a company with which he is connected, e.g. by virtue of being a controlling shareholder, ad valorem stamp duty will apply to the market value of the land, i.e. it will no longer be possible to certify the gift under Category L of the 1987 Exempt Instruments Regulations. Typically, assuming that the land is a business asset, any gain arising would be held over under section 165 TCGA 1992. The section came into force on 28 March 2000 and thus may well have caught out many "innocent" transfers. While there had been expectation that the wording of clause 119 would be amended (by connecting the two paragraphs in sub-clause 1(1) with "and" rather than "or"), this in the event did not happen.

More General Considerations

Even before 28th March 2000, from which date section 119 takes effect, there were difficulties. In a case where the land was to be transferred to the company for value, e.g. in consideration of an issue of shares, the requirement of section 2 Law of Property (Miscellaneous Provisions) Act 1989 that the agreement should be in writing if it is to be valid meant that the straightforward "offer and acceptance" route (see below) could not be used to that extent. One solution might have been to let the matter "rest in contract", the company contracting for the purchase of both the legal and equitable interests therein (but never completing the contract), with the legal title being held by a financial institution having, in effect, the status of a custodian trustee. Any transaction to sell the property in the future would be made by the custodian legal owner (at the instance of the beneficial owner): no liability to ad valorem stamp duty would arise until there was a conveyance or transfer on sale. Given that it was envisaged that such an arrangement would continue in perpetuity, it should have been possible to ensure satisfactory title for a purchaser even where there is to be a borrowing. However, leaving the matter to "rest in contract" might be considered to involve being something of a "hostage to fortune" in terms of possible future developments in stamp duty legislation. Alternatively, a sale to a third party outside the structure for a consideration of not less than the value of the property could take advantage of the sub-sale route under section 58(4) Stamp Act 1891.

Certainly, if the Stamp Office consider that such arrangements are being made to avoid Stamp Duty to a significant extent, perhaps we can expect to see in the future some extension to the tax base to cover such arrangements. If so, it could be the next purchaser in line who is caught with the charge as "holding the parcel", so to speak. Previous purchasers would not have suffered through having the documents transferring title to them unstamped. It was announced by press release on 8th November 2000 that Finance Bill 2001 would introduce stamp duty on the electronic transfer of land and building (made possible by the Electronic Communications Act 2000): might this be a first step towards the levy of stamp duty on transactions?

As another possibility, the taxpayer could, perhaps for capital gains tax as well as other reasons, leave the land out of the transfer of say a business to a company, having the company license or lease the land from him. This latter course does not, however, solve the long-term stamp duty problem with the land (albeit a problem for a purchaser rather than for the landowner for the time being).

Inheritance Tax Planning for A Non-UK Domiciliary

The incentive for a non-UK domiciliary for inheritance tax purposes will be to maximise the value of excluded property, that is property situated outside the UK (section 6(1) IHTA 1984). The standard planning in relation to a valuable house or flat in the UK is to transfer the property into an offshore company, so that what is owned by the individual is not the UK situated property but the non-UK situated shares. Such an arrangement requires consideration of other possible tax implications (for which see paras 17.7 to 17.15 of the writer's book Tax Planning for Private Residences 3rd Edition 1999, published by Butterworths Tolley).

Now, however, whether the property is given to the company or is sold in consideration of the issue of shares, ad valorem stamp duty will apply. The only mitigation technique would seem to be to contract to sell the whole of the interest in the property, without completing the contract, though the uncertain issues raised below may make it worth paying the stamp duty to be certain of the inheritance tax benefit.

Resting in Contract

There may be circumstances where there is no immediate requirement for a stamped document and the purchaser may therefore prefer to "wait and see". In the context of family business affairs transactions have taken place in the past where the matter was left to "rest in contract". This was on the footing that, as and when the contract was completed, ad valorem duty of only 1% (or, since 8 July 1997, whatever was the applicable rate at the date of contract) would be payable. This stratagem remains valid. Even if the contract is completed some years later, duty (under the present law, at least) will be payable on the consideration expressed in the contract (and not, for example, on market value at the date of completion) and at the rates of duty then prevailing. Any increase either in the market value of the asset or in the applicable rate of duty between date of contract and date of completion will not attract stamp duty. There is a specific risk presented by the decision in *Peter Bone Ltd v IRC* [1995] STC 921 where the purchaser company did not acquire the whole of the vendor partnership's legal and equitable interest in the land forming part of the business being sold.

If there is going to be no commercial need ever to proceed to completion (and assuming that this stratagem is not effectively counteracted in future), letting the transfer "rest in contract" indefinitely might well be a reasonable course of action, subject to the risk mentioned above. For capital gains tax purposes, it is the exchange of unconditional contracts which triggers the date of disposal under s.28(1) TCGA 1992. There seems to be no reason in principle why the substantive consideration (i.e. in excess of the customary 10%) should not pass at contract stage, although there may be some disadvantages of leaving the legal estate in the hands of the seller, unless this is for (example) a financial institution acting as a custodian trustee. If the property agreed to be sold is let, it is important to provide in the contract that all rents arising will belong to the purchaser thereafter; similarly, with rights to occupation.

Business Sales to A Company: Offer and Acceptance

It may be possible to avoid a stampable document, through having an oral agreement to sell the business for cash which is then set off on completion of the sale against the debt due from the vendor to the company to subscribe for the shares (*Re Harmony and Montague Tin and Copper Mining Co, Spargo's Case* [1873] 8 Ch App 407). Whether or not the company is the purchaser, the case of *Carlill v Carbolic Smoke Ball Co* [1892] 2 QB 484 confirms that an offer in writing which is accepted either orally or by conduct does not attract ad valorem duty, since there is no written agreement.

Great care must be taken if relying on "offer and acceptance", since a document entered into after the sale which is used as evidence of it may be held to constitute a conveyance on sale (see *Oughtred v IRC* [1960] AC 206). In a case where the owner of a reversionary interest under a Will sold his reversion and acknowledged receipt of the purchase money, that acknowledgement was held by the Court of Appeal to be an agreement for sale of the equitable interest (*Fleetwood-Hesketh v IRC* [1936] 1 KB 351). It should be possible to avoid a stampable document if the subject matter of the agreement is personal property. If it is land, however, s.2 Law of Property (Miscellaneous Provisions) Act 1989 generally requires the agreement to be in writing if it is to be valid: it may be possible to let the transfer of the land "rest in contract" (see above).

There is authority *(Vaughton v Brine* 16 M&W 359*)* that the recording of a normal contract in board minutes will not attract stamp duty. There could be a statutory requirement to record information. For example, where the transfer of the business for some reason does not attract transfer as a going concern treatment for VAT purposes, a VAT invoice (and return) might record the relevant information. This should be sufficient so long as nothing is recorded more than is strictly required by the regulations (para 14(1) Value Added Tax Regulations 1995 SI 1995/2578).

Companies Act Forms

If "offer and acceptance" is used for transfer of a business to a company, a prima facie problem is presented by Companies Act requirements. In the absence of a written agreement for sale, Form 88(3) must be completed by the company issuing the shares and must then be lodged with the Registrar of Companies. Form 88(3), for use only where there is no written contract, gives particulars of a contract relating to shares allotted as fully paid or partly paid up otherwise in cash. Section 88(3) Companies Act 1985 requires its production, duly stamped, to the Registrar of Companies. Form 22 is dispensed with if the details of apportionment have been given on Form 88(3); Form 88(3) may contain a certificate of value. In a case where any consideration is to be in the form of cash, reliance upon an oral contract would not give rise to a liability to file Form 88(3). Nonetheless, section 88 applies only to limited companies. That is, the sale of the business could be to an unlimited company, where no return of allotments is required, and subsequent re-registration of the company as a limited company can be achieved with no stamp duty liability. This stratagem, however, does not overcome the problems with transfers of land discussed above, that section 119 FA 2000 would apply to the transfer to the unlimited company (given that the transferor is connected with the company).

Transfer to the Company: Capital Gains Tax

If the asset qualifies as a business asset for purposes of capital gains tax hold-over relief (within the definition in section 165 TCGA 1992), it may be possible to elect to hold over the gain such that the accrued gain is inherited by the company. The loss of accrued taper relief on making the hold-over claim should be borne in mind. Alternatively, if the asset concerned forms part of a business and it is appropriate to transfer the whole of the business undertaking to the company in consideration of the issue of shares, no capital gains tax need be paid, given section 162 TCGA 1992. The effect is that the gains inherent in the chargeable assets within the business are translated into the shares (so that, if the shares are retained until death, there is the normal tax free uplift to market value provided by section 62 TCGA 1992 and the company acquires the assets at market value). In this case, however, there is clearly a sale for consideration and ad valorem duty will be due, unless it is possible to structure the transaction by means of "offer and acceptance" and the use of an unlimited company. There does remain the stamp duty problem with land, however, unless perhaps the matter is left to "rest in contract" (see above).

Even with the gift of an asset to a company along with capital gains tax hold over relief under section 165 TCGA 1992, beware the circumstance that the asset is subject to a liability thus triggering a stamp duty liability under section 57 SA 1891. It would be better to "leave behind" the liabilities in the hands of the transferor, providing that security for them is not required in the form of the land being transferred.

Other Considerations

When planning asset holding structures, it is as well to take a long-term view. While one should certainly explore the current advantages in terms of stamp duty offered by holding and transferring assets and businesses within a corporate structure, one must consider also capital gains tax and commercial implications. Remember that not only the stamp duty rules but also the whole structure of taxation may be very different in the future from what it is now. Bear in mind also that the professional costs of selling a company tend to be greater than where selling land, as it involves a due diligence exercise and warranties by both directors and shareholders.

Tax Within the Company

Once the asset concerned is in the company, the duty on transfer of the shares for consideration would only be at 0.5%. The problem again, however, becomes capital gains tax, with the notorious double charge on appreciating assets held within a company: taper relief operates only for the benefit of the shareholders. Given appreciation in value, the company will ultimately be liable to corporation tax on chargeable gains on the gains arising within the company (subject to indexation allowance), whether this occurs on sale or on liquidation, and the shareholder will similarly be chargeable on the consequential increase in value of the shares post-taper relief (subject to the tax free uplift to market value on death). If, of course, the company is going to be a long term holder of the assets, it may not much matter that the gain accrues within the company.

The UK Resident Foreign Incorporated Company

Consider the planning possibilities offered by holding UK property within a company incorporated outside the UK (even if resident here for tax purposes). No share register would be kept in the UK and any transfers of shares in the company could be executed and kept outside the UK, with no liability to stamp duty or stamp duty reserve tax (the shares not being "chargeable securities" for purposes of the latter).

If therefore, having acquired the shares in the shares of a foreign company, which owns assets situated in the UK, the purchaser wants to obtain beneficial ownership of those assets, he can simply procure a liquidation of the company. The transfer of the assets to him in the liquidation can be certified under the 1987 Exempt Instruments Regulations and no duty is therefore chargeable.

Offshore Companies

Alternatively, consider the use not of registered shares but of bearer instruments such as warrants which are issued for an insubstantial price. While stamp duty at 1.5% will be payable on the price paid, future transfers of the warrants at their then market value will attract no further charge to stamp duty, as title will pass by delivery, nor will there be a liability to stamp duty reserve tax .

Assets Subject to A Liability

Finally, a significant difference between transfers of unincorporated assets and transfers of shares in companies can be seen with land that is mortgaged. A transfer of mortgaged land where the transferee takes over liability for the mortgage will attract stamp duty on its gross value. If on the other hand the land is held within a company, not only will the rate of duty be reduced from 4% maximum to 0.5%, the 0.5% will be charged on the net value rather than the gross. Thus, a purchaser may acquire shares in such a company. If he then chooses to extract the property from the company either through liquidation or, assuming that the company has sufficient distributable reserves, paying up a dividend in specie with no liability to stamp duty, there can be no further liability to duty: see above.

Conclusion

Fiscal considerations have always played a part in the choice of an appropriate business structure. Now, more than ever, stamp duty among other taxes needs to be taken into account. In cases where an interest in land forms part of the unincorporated business section 119 FA 2000 poses new problems. It can safely be said that stamp duty will continue to evolve; developments are likely to take the form of new anti-avoidance and other rules, as well as increases in rates.