Hong Kong Tax Alert

23 July 2024
2024 Issue No. 10

Court of Appeal (CA) ruled bodies corporate such as limited liability partnerships that do not have "issued share capital" would not qualify for stamp duty relief for intra-group transfer of Hong Kong stock or immovable property

On 5 July 2024, the CA handed down its judgement in *John Wiley & Sons UK2 LLP and Another v The Collector of Stamp Revenue*[1], overturning the decision made by the District Court (DC)[2] that ruled in favor of the duty payers.

The facts

John Wiley & Sons (HK) Limited (HKCo) is a limited company incorporated in Hong Kong under the former Companies Ordinance, Cap 32 (the Former CO).

The entire issued share capital of HKCo was owned by John Wiley & Sons UK2 LLP (LLP 2).

LLP 2 was 100% beneficially owned by its only member, namely John Wiley & Sons UK LLP (LLP 1).

Both LLP 1 and LLP 2 were limited liability partnerships registered under the Limited Liability Partnerships Act 2000 of the UK.

LLP 1 was 100% beneficially owned by its only member, Wiley International LLC (HoldCo), a limited liability company established in the State of Delaware in the USA.

[1] The full CA judgement could be accessed in the link below:

https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=161104&currpage=T

[2] The full DC judgement could be accessed in the link below:

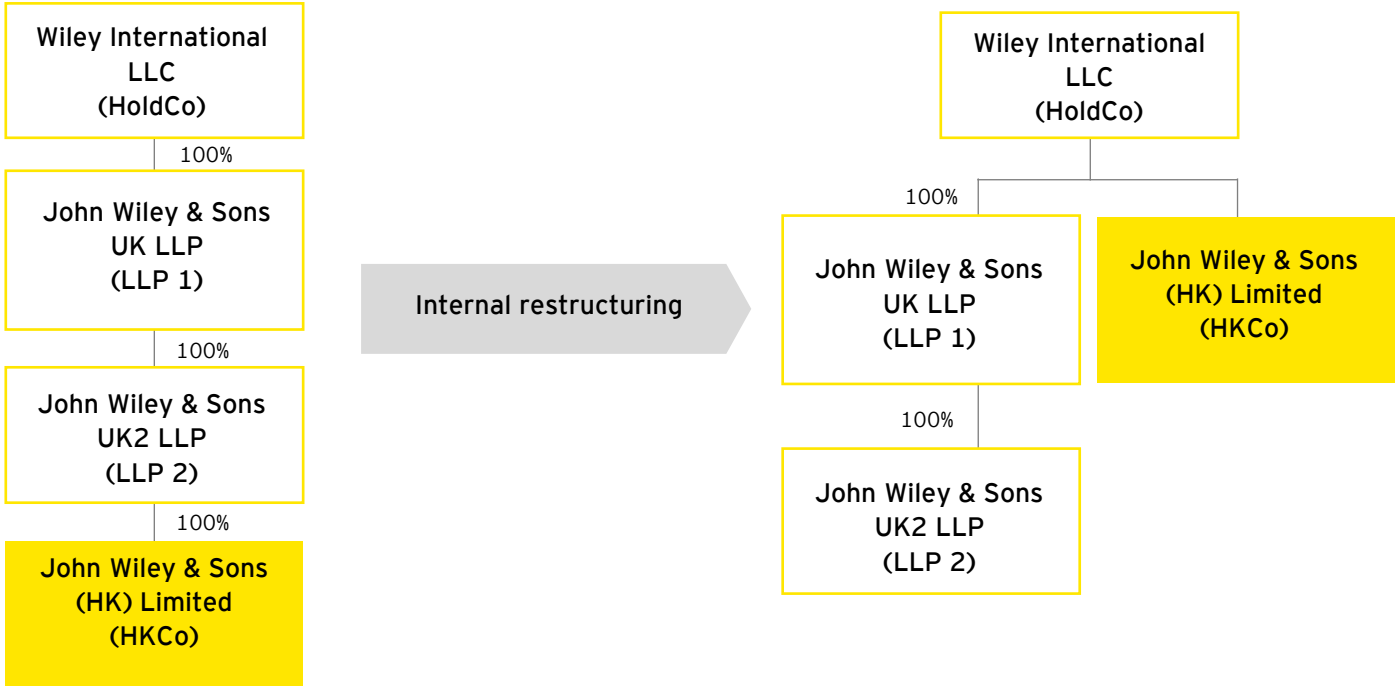
https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=145761&currpage=T

Transfer of HKCo from LLP 2 to Holdco

On 30 April 2019, LLP 2 (as transferor) transferred the entire share capital of HKCo to HoldCo (as transferee) for the consideration of GBP 313,240,835 (the Share Transfer).

The Share Transfer was apparently made as part of an internal group restructuring of the global John Wiley & Sons group of companies and entities.

The diagram below illustrates the intra-group transfer of HKCo:



Claims for stamp duty relief for the intra-group transfer of HKCo

On 29 May 2019, LLP 2 and HoldCo (collectively referred to as the Duty-Payers) applied to the Collector for stamp duty relief in respect of the Share Transfer on the ground that it constituted an intra-group transfer of shares between "bodies corporate" under section 45 of the Stamp Duty Ordinance (SDO).

The Collector rejected the Duty-Payers' claim for stamp duty group relief holding that the 90% test for association in terms beneficially owning at least 90% of the "issued share capital" involved, which is required to be construed in the company law context for section 45 of the SDO, was not satisfied, given that LLP 1 and LLP 2 had no such capital.

The Collector assessed the stamp duty chargeable on the bought and sold notes each in the sum of HK$3,180,602.

Dissatisfied with the assessment, the Duty-Payers lodged an appeal to the DC.

DC Decision

Section 45 was originally contained in Old Section 5A

The judge noted the section 45 of the SDO was originally contained in section 5A of the old Stamp Ordinance (Old Section 5A). Under Old Section 5A, relief was given where the effect of an instrument was to "convey or transfer of a beneficial interest in property from one associated company to another such company" and the test of association required for granting relief was that both were "companies with limited liability and either one of them is the beneficial owner of not less than ninety per cent of the issued share capital of the other; or not less than ninety per cent of the issued share capital of each of them is in the beneficial ownership of a third company with limited liability".

Thus, the term "issued share capital" in Old Section 5A would have to be construed in the context of a "company with limited liability" and therefore in the company law context.

However, that context was removed in 1981 when Old Section 5A was completely rewritten into the current section 45 of the SDO, which introduced the concept of "bodes corporate" while "issued share capital" remained the definition of association.

The judge then reasoned that with the removal of the prerequisite of "companies with limited liability", there is no language within section 45 or other context that points to the Collector's interpretation and displaces the starting point of construing the term "issued share capital" according to its natural and ordinary meaning.

Based on its natural and ordinary meaning, the judge than ruled that "it is evident that [LLP 2 and LLP 1] have issued share capital within the meaning of section 45, each in the nominal value of GBP 100 and they have been divided into 2 portions or shares – GBP 1 and GBP 99, which had been taken up and paid for by, therefore issued to within the meaning of section 45, the initial members. As said those shares in the capital had changed hands in the meantime resulting in the ownership position above at the time of the Share Transfer. It is also amply evident that [LLP 2 and LLP 1] together with [HoldCo] met the test of closeness in their association in that [LLP 2] was ultimately wholly owned by [HoldCo]."

Thus, the judge held that the Duty-Payers are "associated bodies corporate" within the meaning of section 45 of the SDO, and the Collector was not correct in rejecting the Duty-payers' claim for stamp duty group relief.

Dissatisfied, the Collector appealed to the CA against the decision of the DC.

CA decision

Historical context of Old Section 5A and section 45 of the SDO

Section 45 of the SDO was adopted from the Finance Act 1967 (the 1967 Act) of the UK, which made certain amendments to the corresponding stamp duty group relief provisions contained in the earlier legislative provisions of the UK (the 1967 amendments).

Specifically, the original section 42 (Original Section 42) that granted stamp duty group relief in the UK contained in the earlier legislative provisions was amended by the 1967 amendments, now referred to as Amended Section 42.

The 1967 amendments replaced the term "company with limited liability" in the Original Section 42 by the term "body corporate" in the Amended Section 42.

The 1967 amendments in the UK were adopted in Hong Kong in 1981, i.e. the rewritten of Old Section 5A into the current form of section 45 of the SDO.

As a result of the 1967 amendments, the CA judge noted that the term "bodies corporate" in the UK was no longer confined to "company" within the meaning of Companies Act 1929, or the Companies Act (Northern Ireland) 1932 but include foreign companies as well.

The CA judge then considered how the terms "bodies corporate" and "issued share capital" employed in section 45 of the SDO should be interpreted against this historical context.

Although the expression "body corporate" and "issued share capital" in the Amended Section 42 were not specifically defined, the CA judge further considered that it would reasonably be thought that these two expressions in the Amended Section 42 were intended to bear the same meanings as they were used in an earlier UK Act in the company laws context.

Therefore, the historical context of the Amended Section 42/section 45 of the SDO indicates that the expression "body corporate" is wider than the concept of "company" incorporated under the relevant Companies Act/Ordinance in the UK and Hong Kong and includes foreign companies.

What is less clear, though, is whether, for the purpose of section 45 of the SDO, "body corporate" can include other types of local or overseas body corporate (i.e., other than companies) such as an overseas limited liability partnership. The answer to that question depends on the meaning that should properly be given to the expression "issued share capital". This is because stamp duty relief is available to associated bodies corporate only if they can satisfy the test of owning or being owned at least 90% of the "issued share capital".

The CA judge considered that the expression "issued share capital" is a well understood concept under the company laws in the UK and Hong Kong and used frequently in tax statutes. As such, the term "issued share capital" would normally need to be interpreted by reference to its meaning under the company laws, unless the relevant legislative provisions or context otherwise require.

In support of his view above, the CA judge quoted Canada Safeway Ltd v IRC [1973] Ch 374 and other tax cases. More relevantly, the judge (Megarry J) in Canada Safeway Ltd v IRC [1973] Ch 374 referred to the company law in the UK to interpret whether it was the nominal (or par) value or the market value of the "issued share capital" of a Canada company that should be counted in determining whether the Canada company can qualify for the stamp duty group relief in the UK.

The CA judge then concluded that the expression "body corporate" in the context of section 45 of the SDO is wider than "company" incorporated under the Former CO/New CO and includes foreign companies. On the other hand, the expression "issued share capital" is a well understood concept under company laws. When used in a tax statute, it should prima facie, be interpreted to bear the same meaning as it is employed in the company law context, in the absence of any specific or different definition for that expression or any special context which suggests a different meaning is intended. There is nothing in the context or language of section 45 to indicate that the legislature intends to use the expression "issued share capital" in any different sense.

In the company law context, "share capital" would carry the idea of shares (in discrete or standard units) being allotted or issued to a shareholder in return for money or other forms of consideration paid to or received by the company as capital.

The CA judge then considered that no shares (in the sense of discrete or standard units) in the capital of LLP 2/LLP 1 ever exist, and no such shares have ever been issued to their respective members. Hence, no capital paid by members to LLP 2 and LLP 1 could be regarded as the "issued share capital" of LLP 2/LLP 1 within the meaning of section 45 of the SDO.

The CA judge thus also dismissed Counsel for the Duty-Payers' submission that, for the purpose of section 45, "share capital" signifies, or refers to, "a class of participation interest in the corpus and income of the corporation (or body corporate) issuing it that economically and juristically analogous to share capital at Hong Kong law, albeit not necessarily identical to it".

The Collector's appeal was therefore allowed.

Other non-binding side remarks made by the CA judge

Under the New CO in Hong Kong, shares of a company will no longer have a nominal (or par) value. Therefore, Megarry J's decision in Canada Safeway Ltd v IRC [1973] Ch 374 that the association requirement for stamp duty group relief be ascertained based on the nominal value of the issued share capital of a company will have to be modified for the purpose of section 45 of the SDO.

Instead of using the nominal value of the share capital for determining whether the 90% test for association is satisfied, the CA judge considered that "reference will likely have to be made to the total consideration agreed for the issuance or allotment of shares as have been issued by the company".

It is however unclear what exactly the CA judge meant by the phrase quoted above. Perhaps, it may mean that when new shares are issued at an agreed consideration, the other existing shares of the company may then have to be valued based on the consideration received for the issuance of the new shares for the purpose of ascertaining the portion of the shareholding of the existing shareholders and that of the new shareholder.

However, under the new CO, a company will still need to maintain and file with the Company Registry the number of shares it has issued. Thus, it seems that in practice ascertaining the percentage of the shareholding of a shareholder in a company by reference to the number of issued shares would not pose any difficulty and may also achieve what the CA judge may have in mind.

Observation

If the Duty-Payers do not further appeal, the CA decision would mean types of bodies corporate other than companies incorporated in Hong Kong or overseas would most unlikely be able to claim stamp duty group relief under section 45 of the SDO.

Clients who have employed such other types of bodies corporate in their ownership structure of Hong Kong stock and immovable property will need to consider the Hong Kong stamp duty implications if they contemplate any intra-group transfer of such assets. Where necessary, professional tax advice should be sought.

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