Court of Appeal overturns ruling that UK LLP has issued share capital for stamp duty relief purposes

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In brief

On 5 July 2024, the Court of Appeal (CoA) handed down its judgement in *John Wiley & Sons UK2 LLP and another v. The Collector of Stamp Revenue*[1], overturning the District Court's (DC) decision.

Adopting the approach of Megarry J in the UK case, *Canada Safeway Ltd v IRC* [1937] 1 CH 374, the CoA determined that the term 'issued share capital' should be interpreted to bear the same meaning as it is employed in the company law context. Notwithstanding the fact that the current section 45 of the Stamp Duty Ordinance (SDO) has replaced the term 'company with limited liability' with 'body corporate', the legislative intent remained that intra-group stamp duty relief applies only to associated companies that satisfy the 90% issued share capital association requirement. As such, a member's share or interest in a UK limited liability partnership (LLP) is not considered equivalent to a share in a company with share capital. This interpretation led to the conclusion that the appellants failed to meet the 90% association requirement, rendering them ineligible for the stamp duty relief on an intra-group transfer of shares in a Hong Kong company.

This news flash summarises the CoA's decision and its implications.

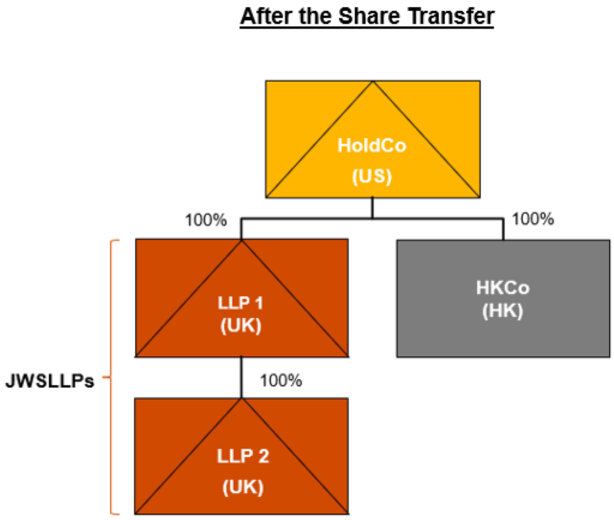
In detail

Background of the case

Section 45 of the SDO provides stamp duty relief for the conveyance of Hong Kong immovable property or transfer of Hong Kong stock between associated bodies corporate, provided that certain conditions are met (s.45 relief). Two bodies corporate are considered 'associated' if (i) one is the beneficial owner of at least 90% of the issued share capital of the other; or (ii) a third body corporate is the beneficial owner of at least 90% of the issued share capital of each of the two bodies corporate.

The appellants, John Wiley & Sons UK2 LLP (LLP 2) and Wiley International LLC (HoldCo) (collectively 'Appellants'), are members of the John Wiley & Sons group. LLP 2 and John Wiley & Sons UK LLP (LLP 1) (collectively 'JWSLLPs') were incorporated as LLPs in the UK under the Limited Liability Partnerships Act 2000. As part of an internal group restructuring, the entire share capital of John Wiley & Sons (HK) Limited (HKCo) was transferred from LLP 2 to HoldCo (Share Transfer).

The organisation charts of the relevant entities before and after the Share Transfer are set out below.



The Appellants applied for s.45 relief in respect of the Share Transfer. While the Collector of Stamp Revenue (Collector) accepted that the Appellants were bodies corporate, he rejected the Appellants' application on the grounds that the JWSLLPs did not have issued share capital, and therefore the Appellants (being the transferor and transferee) could not be associated for the purpose of s.45 relief. The Appellants appealed to the DC.

Judgement of the DC

The DC adopted the purposive approach to statutory interpretation and held that the term 'issued share capital', which is not defined in the SDO, should be interpreted to mean 'having been legally given to (those entitled to the share capital) in a legally completed transaction'. A body corporate has 'share capital' if its capital is divisible into quantifiable portions, and if the sum of these portions constitutes the total value of the capital. Furthermore, this division must be legally recognised in the jurisdiction of incorporation.

As the capital of JWSLLPs had been divided into quantifiable portions and taken up by its initial members, the DC concluded that JWSLLPs had 'issued share capital' within the meaning of section 45 of the SDO. Accordingly, the Appellants were considered associated bodies corporate and were entitled to s.45 relief. Please refer to our previous news flash for details of the DC's reasoning[2].

The Collector, dissatisfied with the DC's judgement, appealed to the CoA, which heard the case on 26 April 2024.

Judgement of the CoA

The salient points of the CoA's judgement are summarised below.

- The CoA concurred with the DC's adoption of a purposive approach to statutory interpretation. As regards the way to interpret section 45 of the SDO, the Collector favoured a strict textual analysis, while the Appellants proposed a liberal interpretation to align with the statute's intent, meaning and spirit, especially regarding exemptions. However, the CoA did not find either approach to be decisive.

- In discerning the true construction of section 45, the CoA emphasised the importance of considering, among other things, the object or purpose and the context of section 45, as well as the language used by the legislature.

- There was no dispute about the statutory object or purpose of section 45 or its predecessor (i.e. old section 5A of the old Stamp Ordinance), which indicates that s.45 relief was introduced to provide stamp duty relief for intra-group transfer of dutiable properties.

- To understand the context of section 45 and its predecessor, the CoA traced the historical development of section 45. The old section 5A originated from the UK provision that granted intra-group stamp duty relief. Under the old section 5A, stamp duty relief would be granted when property was transferred between associated 'companies with limited liability'. The relief required a minimum 90% beneficial ownership in the 'issued share capital' of another company.

- In 1967, amendments were made to the UK provision to: (i) substitute 'company with limited liability' with 'body corporate'; and (ii) substitute references to 'issued share capital' for references to 'ordinary share capital' for determining the amount of capital held through other bodies corporate. These concepts were based on a separate piece of UK legislation concerning a levy of tax called 'national defence contribution'.

- When the old section 5A under the old Stamp Ordinance was rewritten into the current section 45 of the SDO in 1981, the term 'companies with limited liability' was replaced with 'bodies corporate' to align with the amended UK provision. Nonetheless, 'issued share capital' continued to be the criterion for determining the association requirement.

- Tracing back further, the CoA found that, previously, the term 'body corporate' was apparently intended to refer to a 'company' as defined in the UK Companies Acts. However, subsequent amendments to the legislation had severed the link between 'body corporate' and 'company'.

- Reflecting on the historical context of the relevant UK and Hong Kong stamp duty relief legislation, the CoA concluded that the term 'body corporate' encompasses a broader scope than the concept of 'company' as defined under the relevant UK Companies Acts and Hong Kong Companies Ordinances. This was intended to extend relief to transactions involving overseas bodies corporate, provided that the relevant requirements were satisfied.

- The CoA observed that while amendments to UK legislation concerning national defence contribution severed the link between 'body corporate' and 'company', no legislative materials indicate that the UK Parliament intended to use the term 'issued share capital' in any different sense when the stamp duty relief provision was amended in 1967.

- Turning on the statutory language, the Collector argued that the term 'issued share capital' should be accorded its natural and ordinary meaning. In support of his argument, the Collector relied on the judgement of Megarry J in the *Canada Safeway* case. Briefly, this case concerned the interpretation of the UK provision corresponding to section 45. The question there was whether the '90% of the issued share capital' threshold should be calculated based on the actual value or the nominal value of the shares. Megarry J ruled in favour of using the nominal value.

- The CoA acknowledged that although the *Canada Safeway* case did not serve as a direct precedent for the current appeal, it established a method for interpreting the term 'issued share capital' that has since been applied in various UK tax contexts. Specifically, Megarry J's approach applies the definition of 'issued share capital' in company law when construing stamp duty legislation.

- Applying Megarry J's approach within the framework of the current Hong Kong Companies Ordinance, Cap. 622 (New CO) (which no longer adopts the concept of nominal (or par) value) with modification, the CoA found in favour of the Collector's submission that for an entity to be considered as having an 'issued share capital', it must adhere to the New CO's requirements for public disclosure of specific details regarding its share capital. This disclosure is essential to enable the percentage of ownership of issued share capital to be ascertained with certainty at any one time.

- The CoA concluded that the term 'issued share capital' has a well-established meaning under company law, which should be adopted when interpreting a tax statute unless there is a specific or alternative definition provided, or the context suggests a different interpretation. There is no indication that the legislature intended the expression 'issued share capital' to be understood in any different sense. Despite using the term 'body corporate' in the 1981 amendment, it remained the legislative intention for s.45 relief to be available to associated companies that satisfy the association requirement, but not to other types of corporate entity.

- The CoA rejected the Appellant's submission that 'share capital' refers to a class of participation interest in the corpus and income of a body corporate that is economically and juristically analogous to share capital under Hong Kong law. The CoA reasoned that this interpretation is vague and uncertain, and finds no support from the historical context or language of section 45, nor from any legal precedents.

- Based on the above, the CoA ruled that, even though the JWSLLPs are bodies corporate, they are not 'companies'. Furthermore, since the JWSLLPs did not issue shares to their members, the capital contributed by their members cannot be regarded as 'issued share capital' within the meaning of section 45. Consequently, s.45 relief is not available to the bought and sold notes in respect of the Share Transfer.

Our observation: *Both the DC and the CoA cited the* Canada Safeway *case to support their judgements, yet they reached different conclusions. The DC, relying on Megarry J's explanation that 'a share capital is one that is divided into shares of a fixed amount', concluded that a membership interest in a UK LLP falls within the class of participation interest denoted by the words 'share capital' in section 45. In contrast, the CoA adopted Megarry J's approach that the term 'issued share capital' should be construed as it is in company law. These differing interpretations adopted by the DC and CoA highlight the complexities involved in statutory interpretation.*

It is beyond dispute that the legislative purpose of section 45 is to provide stamp duty relief for intra-group transfers of Hong Kong shares or immovable properties when there is no significant change in ultimate beneficial ownership. The Share Transfer, which did not alter the ultimate beneficial ownership of the shares concerned, seems to closely align with the legislative intent behind section 45 and, therefore, should qualify for relief under this section. However, the approach employed by the CoA has given the term 'issued share capital' an unduly narrow and rigid interpretation.

As an aside, the CoA noted that the test proffered by Megarry J, which uses the nominal value to determine whether the 90% association requirement is met, will need to be modified under the no-par regime introduced by the New CO. To reflect the dynamic nature of business laws, it seems justifiable for section 45 of the SDO to be construed in a manner that aligns with the contemporary array of business entities and ownership structures.

The takeaway

Cases heard by the CoA may be permitted for further appeal to the Court of Final Appeal (CFA) if certain prescribed conditions are met. Duty payers whose s.45 relief applications have been put on hold by the Stamp Office should continue to pay close attention to any potential appeal of the CoA's judgement to the CFA. An appeal to the CFA may result in a decision that either upholds or deviates from the CoA's judgement.

Meanwhile, businesses contemplating corporate restructuring that involves direct or intermediate entities within a group, particularly those that are non-traditional share-issuing companies, should consider obtaining professional advice to assess whether such transactions may attract Hong Kong stamp duty, and explore ways to legitimately qualify for any relief or otherwise contain the potential liability.

Endnotes

1. The CoA's judgement can be accessed via this link:
   https://legalref.judiciary.hk/lrs/common/ju/ju_frame.jsp?DIS=161104&currpage=T

2. Our news flash on the DC's judgement can be accessed via this link:
   https://www.pwchk.com/en/hk-tax-news/2022q3/hongkongtax-news-jul2022-9.pdf

Let's talk

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