STAMP DUTY ON SHARES DERIVING THEIR VALUE FROM IRISH IMMOVABLE PROPERTY

JUNE 2018

Intention

Section 31C (Section 31C) of the Stamp Duties Consolidation Act 2017 applies from 6 December 2017subject to a grace period which has now expired.

The intention of Section 31C is that on the sale or giving of a controlling share or interest in a company or other entity such as a partnership or Irish Real Estate Fund (IREF) (each a "Target Entity") which derives its value or the greater part of its value directly or indirectly from Irish non-residential property with development potential, a stamp duty will apply to the document of transfer at 6% of the gross value of that property

It seems that the primary aim of Section 31C is not to increase the tax yield directly but rather, in the light of the increase in the rate of duty to 6% imposed from 11 October 2017 on transfers on sale of Irish non-residential property, to neutralise the attempted use of certain stamp duty avoidance schemes by the transfer of control of Target Entities directly or indirectly owning such property.

Unfortunately, Section 31C will not always apply as an anti-avoidance measure.

The charge

For Section 31C to apply, there must be:

- a conveyance or transfer on sale of stocks or marketable securities or other instrument effecting the transfer on sale of an interest in a Target Entity;
- created on the occasion of a change in the person having direct or indirect control over the non-residential property concerned.

The stocks marketable securities or other interest in the Target Entity transferred, must derive their value or the greater part of their value directly or indirectly from Irish non-residential property.

Also, it must be reasonable to assume (the Assumption) that the non-residential property owned by the Target entity:-

- was acquired by the Target Entity with the sole or main object of realising a gain;
- was or is being developed by the Target Entity with the sole or main object of making a gain; or

- was or is held as trading stock by the Target Entity.

The Assumption, an imputed motive test, should enable practitioners to exclude a significant number of transfers which would otherwise be affected by Section 31C.

Relevance of gross value of the non-residential property

Section 31C (8)(b), makes it clear that in assessing stamp duty on the conveyance or transfer on sale for the purposes of Section 31C, regard is to be had to the gross value of the non-residential property held by the Target Entity. This means that such items as a mortgage on the property are ignored.

Transitional measures

A transfer executed before 1 March 2018 are not affected by Section 31C where it is shown to Revenue's satisfaction that it was executed pursuant to a contract entered into prior to 6 December 2016.

How Section 31C works

This is best illustrated by examples.

Example 1

In 2001, Fred's company acquired a large development site with the intention of selling it at a gain. In late 2017, he agrees to sell the company to Bert for €23m. The contract for the sale of the site to the Company is executed on 7 December 2017. This is too late to avoid the impact of Section 31C. Any transfer of the shares in the company to Bert will attract stamp duty at 6% of the value of the property.

ABC Co is a property development company owned by its founder, Jim Brick. It owns residential property worth €2m and non-residential property worth €2.2m. Taking all things into consideration, including borrowings, ABC Co has a market value of €1.4m. Jim, aged over 55, decides to give the company to his 2 sons and 1 daughter.

If on 1 December 2017 stock transfers were executed to transfer all of the shares in ABC Co to the children, the stock transfers would have attracted stamp duty in aggregate under the conveyance on sale head at 1% of the selling price, that is, €14,000.

If, assuming no change in value, the stock transfers were executed on 1 February 2018, the stamp duty on the stock transfers in aggregate would be 6% of €2.2m =€132,000.

If ABC Co did not derive the greater part of its value from Irish non-residential property, there would be no change in the duty payable for transfers executed on either date.

However, Section 31C has no impact on most regular transactions where the value of non-residential property held is not a dominant factor in the overall value of an entity.

Example 2

On 29 January 2018, Can Co Inc., a company based in Canada, acquires NZ Co PLC, a company based in New Zealand for €5m. At the time of the acquisition, NZ Co PLC has a factory in Wexford used to manufacture widgets but it also owns a vacant site, worth €500,000, adjacent to the factory for which planning permission for a showroom and offices exists and which NZ Co PLC intends to develop and sell. The factory is not development property but the site will be. However, as the shares in NZ PLC do not derive their value or the greater part of *their value directly or indirectly from Irish immovable property, no Irish stamp duty will be payable at 6% on any stock transfer to Can Co Inc. by reference to gross value of the vacant site.*

Example 3

On 8 January 2018, NY Co Inc., a company based in New York, acquires BL Co SA, a company based in Belgium. At the time of the acquisition, BL Co SA has a factory in Dublin used to manufacture computer parts. The factory is non-residential but it is not development property and BL Co SA had no intention of developing it. Clearly any transfer document of the shares in BL Co SA to NY Co Inc. will not be subject to the charge to stamp duty.

Transfers of interests higher up the chain of ownership

Where the circumstances giving rise to the charge apply to an entity (the Top Entity) which derives its value from a Target Entity, then the charge will apply to the instrument transferring a controlling interest in the Top Entity.

Example

Gnat Investments Limited is a pure holding company. It owns all of the shares in Gnat Management Limited which is a management company which in turn owns all of the shares in Gnat Properties Limited. Gnat Properties Limited is a property development company owning Irish non-residential property with development potential worth €10m. As a result of borrowings from its bank, the entire Gnat group has a net worth of €1m.

On 15 February 2018, the shareholders of Gnat Investments agree to sell it to Fish investments Limited for €1m. The stock transfers in the deal will attract stamp duty at 6% of €10m (€60,000).

Finding the conveyance on sale or transfer to stamp.

Where:

- there is a change of ownership in the interests in a Target Entity resulting in a "change of control";
- The Target Entity derives its value or the greater part of its value from Irish immovable property;
- no conveyance on sale or transfer of the interest sold is executed, but the parties have generated an agreement for sale; and
- the Assumption applies to the Irish non-residential property held by the Target Entity;

then the contract or agreement for the shares or other relevant interest in the Target Entity will be regarded as a transfer or conveyance on sale attracting duty as if it were a conveyance or transfer of the Target Entity resulting in a change of control.

Section 31C fails to specify the date which will be relevant for stamping without penalty. On this basis it might be safe to assume that the normal 30 day rule will apply.

In a number of circumstances, on sale involving a change of control of a Target Entity may occur without the necessity of creating a conveyance or transfer on sale or an agreement for sale. This can occur, for example, where shares in a company are redeemed or cancelled. In such cases, it seems reasonable to believe that the charge to stamp duty will not apply unless of course the transaction is implemented as part of an anti-avoidance scheme. Accordingly, Section 31C may not always be fully effective in achieving the intention of the legislature.

Section 31C (8)(a) asset injections into Target Entities

According to Section 31C (8)(a), in calculation the value of the non-residential property held by the Target Entity for Stamp Duty purposes, you ignore any arrangement for avoiding tax or duty made before the conveyance or transfer of the Target Entity which involves a transfer by a connected person of money or other assets held by the Target Entity.

Subsection (8)(a) may have been inspired by Revenue's awareness of the steps of a scheme which was used to avoid the charge to Capital Gains Tax whereby, on a sale of a company which would otherwise have derived its value or the greater part of its value from land in the State, assets other than Irish land were injected into the company before the sale so as to reduce the proportion of the company's assets derived from Irish land to less than half, thus avoiding the charge. Under Subsection31C (8)(a) any such actions will not be effective.

Stocks, marketable securities, units or interests in a Target Entity deemed to be land

For the purposes of the Section, stocks, marketable securities, units or interests in a Target Entity are deemed to be land.

Enforcement

With the traditional conveyance or transfer on sale, there is an indirect enforcement mechanism when the accountable person fails to stamp the transfer document. Where no stamp duty certificate is produced for a transfer document:-

- a subsequent purchaser will object to the title or
- where the transfer is being registered with the Property Registration Authority, the Registrar of Titles will refuse to proceed with the registration.

With Section 31C, such difficulty may not become apparent in relation to the title documents especially where ownership has been transfer a level above the Target Entity which holds the immovable property. Also, if the Target Entity is not an Irish Target Entity, Revenue may have difficulty in enforcing the charge in a foreign jurisdiction. The fact that there may be difficulties with enforcement is a serious flaw Section 31C.

Disclaimer

This note is a general discussion only of the law relating to stamp duty in Ireland in so far as it concerns Section 31C and does not purport to be a comprehensive examination of the law/legal advice. Before taking any action, full professional advice should be obtained.

In conclusion

As well as being an anti-avoidance measure, Section 31C presents another item for practitioners to put on the checklist when acting in the purchase of interests in a Target Entity and a trap for the unwary.

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