Secondaries and UK Stamp Duty

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In private equity secondary transactions, it is commonly assumed that UK stamp duty is not payable. However, in light of the latest HMRC consultation on modernising stamp duty on shares, the approach to dealing with stamp duty on secondaries may be due to change.

The HMRC consultation, which closes on 13 October 2020, focuses on share transfers and does not expressly deal with transfers of partnership interests. This is a missed opportunity because the stamp duty treatment of secondaries involving the transfer of an interest in a partnership is one of the key areas where the stamp duty regime is outdated and impractical.

What is the current practice on secondary transactions?

In theory, UK stamp duty applies on any transfer of an interest in a partnership that holds shares. It doesn't matter if the shares are issued by UK or non-UK companies. Stamp duty is payable on the relevant proportion of the net value of the shares held by the partnership (being the market value of the shares less any loan secured solely on the shares).

However, in practice, stamp duty is not normally paid on the transfer of partnership interests.

If the transfer documents are executed outside of the UK and the transfer of the partnership interest does not relate to anything situated or to be done in the UK (for example, the partnership is established outside the UK, none of the parties are in the UK and completion takes place outside the UK), then the transfer should be outside the scope of UK stamp duty.

Even if the transfer is within the territorial scope of UK stamp duty, there is currently no legal requirement to submit a partnership transfer for stamping. Stamp duty is not a directly assessed tax.

Instead the consequence of a document not being duly stamped is that the unstamped document cannot be given in evidence in any court proceedings or be available for any purpose in the UK. In practice, in the case of a transfer of a partnership interest in a private equity fund, it is unlikely that the sale agreement (or any related transfer documents) would need to be used in the UK for any purpose, so stamp duty is not paid.

In secondary transactions, the sale agreement and the transfer documents are typically executed and retained outside of the UK and the sale agreement may provide for any UK stamp duty cost to be borne by the buyer or split 50:50 between the buyer and the seller (but no stamp duty would actually be paid, except in the unlikely circumstance where the original transfer document is required to be brought into the UK for use in the UK).

What might be going to change?

The UK government is currently consulting on changes to the UK stamp duty regime. This follows on from a report published by the Office of Tax Simplification in July 2017 which recommended modernising UK stamp duty, in particular by removing the requirement for the stamping of paper documents and replacing that with a digitised self-assessment process.

In the case of partnership transfers, the OTS report recommended that the scope of stamp duty on partnership transfers be considered as a policy matter and noted that less than 50 partnership transfers are submitted to HMRC for stamping each year. The low number may be indicative of the market practice that stamp duty is generally not paid on partnership transfers.

One possible outcome of the current HMRC consultation is that UK stamp duty on transfers of partnership interests could be abolished. This would bring UK stamp duty in line with UK stamp duty reserve tax.

An alternative outcome is that, when stamp duty ceases to be voluntary, the territorial scope of UK stamp duty is narrowed so that it only applies to transfers of interests in partnerships to the extent that the partnership holds UK shares.

If this approach is adopted then offshore execution would no longer be required. UK stamp duty would not apply to transfers relating to partnership interests that do not hold UK shares, wherever the transfer is executed. Narrowing the territorial scope of UK stamp duty to make the place of execution of a document no longer relevant would be a welcome change, especially in times when business travel has become more difficult.

What is the concern for secondary transactions?

However, there may be a significant practical difficulty for secondary transactions if UK stamp duty becomes assessable on transfers of partnership interests that hold UK shares.

To calculate the stamp duty, the buyer of the partnership interest would need to know the value of the UK shares held by the partnership. The buyer in a secondary transaction is likely to be acquiring a minority interest in the fund from the seller. The fund may have multiple investments. Moreover, any investments may be held through a series of partnerships (and it would need to be clear whether the modernised stamp duty applied only to directly held shares, or also included interests in UK shares held indirectly).

Consequently, it may be impractical for a buyer in a secondary transaction to determine whether there are UK shares held by the fund and if so, the value of those UK shares. This is especially likely to be the case where the secondary is not GP-led, so that only limited information about the fund's investments is available. The uncertainty could impact on the pricing and execution of the transaction.

The potential impact on private equity secondary transactions is a point that so far the HMRC consultation on modernising stamp duty has not yet taken into account.

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