Practice guide

UK companies listing in the US

SPEED READ UK shares may be listed in the US for a variety of reasons, including as a result of an ‘inversion’ transaction. Historically, UK companies have accessed the US equity capital markets through American Depositary Receipts (ADRs). The *HSBC* decisions have reduced the cost of issuing ADRs, and a new alternative to ADRs has emerged: UK shares traded directly on the US markets. These and other important issues should be considered by any group thinking about listing a UK company in the US.

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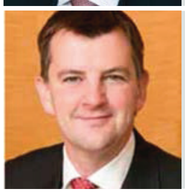

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Why might a UK company seek a US listing of its shares? For an established group with a primary listing in London, a secondary listing in the US could be a means of access to a new pool of capital, or possibly a consequence of the acquisition of a US company through a share-for-share exchange. A growing biotech or IT company deciding where to float might be attracted by the perception of greater investor appetite and more attention from analysts. Or perhaps a US listing might be a consequence of a redomiciliation or an ‘inversion’ transaction (see the boxed text on page 16) influenced by the advantages of the UK tax system over that of the US.

A new alternative to ADRs has emerged: the phenomenon of UK shares traded directly on the US markets

ADRs and the 1.5% charge

For many years, UK companies have accessed the US equity capital markets through the issuance of American depositary receipts (ADRs). Since ADRs were first created for Selfridge & Co in 1927, US investors have been attracted by the packaging of UK shares into US dollar-paying securities, which are more easily comparable to US securities and which can be traded, cleared and settled in line with US market conventions.

Less attractive was the 1.5% stamp duty or SDRT ‘entry charge’ on putting shares into the ADR system (particularly since the ability to trade stamp-free within the system may not always be fully reflected in the pricing of ADRs, in comparison with ordinary shares trading subject to 0.5% SDRT in London). Mitigation of the 1.5% charge through the use of non-sterling bearer shares, as seen on the BP/Amoco and Vodafone/Mannesmann transactions, was quickly curtailed. Using technology seen on the Royal Dutch Shell unification, the Aon, Rowan and Ensco ‘inversion’ transactions showed how stamp costs could be minimised by putting UK shares into an ADR system at a time when they had little value (see the article ‘US inversions through European mergers’ (Tim Sanders and Eric Sensenbrenner) *Tax Journal*, dated 28 June 2013), but this mechanism was not appropriate for ordinary capital raisings. On a share-for-share acquisition of a US target by a UK company, if it was anticipated that a ‘flowback’ of UK shares from US markets may result in the cancellation of newly-issued ADRs and the withdrawal of underlying shares, mechanisms could be adopted to prevent SDRT being wasted on soon-to-be cancelled ADRs. This which was helpful, but it was again of limited application.

As UK corporation tax reforms progressed, attention increasingly turned to the possibility of US listings of companies which are resident in the UK, but incorporated in a stamp-free jurisdiction such as Jersey or Bermuda. For groups weighing up the best place to establish a US listed holding company, the UK struggled to compete with the attractions of the Irish tax regime – which include the non-application, in practice, of 1% Irish stamp duty to transfers of Irish shares traded on US markets and held through the Depositary Trust Company (DTC). The attractions of Ireland continue even after the UK tax regime has improved, as evidenced by the announcement on 18 February that King Digital Entertainment, the UK-based creator of ‘Candy Crush Saga’, plans to float in the US through an Irish holding company.

HSBC – good news for ADRs

The SDRT position for UK companies listing in the US has been much improved by the two *HSBC* cases (*HSBC Holdings PLC and Vidacos Nominees Ltd v HMRC* (C-569/07) and *HSBC Holdings PLC and the Bank of New York Mellon Corporation v HMRC* [2012] UKFTT 163). The decision of the CJEU in the first *HSBC* case was followed by two years of uncertainty around the precise ambit and basis of the decision – in particular, around its applicability to issues of shares into the US markets. In the second *HSBC* case, however, the First-tier Tribunal has confirmed that arts 10 and 11 of the Capital Duties Directive 69/335/EEC preclude a 1.5% SDRT charge on the issue of shares or securities by an EU issuer to a depositary, even if the depositary and investors are located outside the EU.

Guidance published following the second *HSBC* decision confirms that HMRC will no longer seek to impose SDRT at the rate of 1.5% on issues of UK shares to depositary receipt issuers and clearance services outside the EU. HMRC accepts that the decision applies not only to issues of shares or securities, but also to transfers of shares or securities to depositary receipts systems and clearance services – provided such transfers are 'an integral part of an issue of share capital'.

It may be noted that, whilst helpful, HMRC's guidance is in a number of ways narrower than the decision of the FTT. In relation to art 11 of the Capital Duties Directive, the proper test is whether a transfer 'forms an integral part of an overall transaction with regard to the raising of capital'. In relation to art 10 of the Directive, it would appear that there should be a separate test of whether the transfer is 'in the course of an increase in share capital'. The narrower, conflated formulation adopted in HMRC's published guidance does not, however, appear to be causing hardship, and the authors' experience is that HMRC seems to apply its 'integral' test quite broadly.

It is important to bear in mind that a 1.5% stamp duty or SDRT charge may still arise where existing shares are transferred into a depositary receipts system or clearance service. This may be the case where existing shares are sold as part of an IPO, or are otherwise put into a depositary receipts system or clearance service around the same time as the IPO (unless, perhaps, the deposit of shares itself falls to be treated as an integral part of a raising of capital, or in the course of an increase in share capital; see the boxed text overleaf).

The introduction of a revamped, EU law-compliant system of collecting SDRT in connection with ADRs thankfully seems out of the question at present. Unfortunately, a repeal of the provisions of FA 1986 which have been held to be contrary to EU law is not on the cards either. This unhelpful divergence between statute and EU law has at times led to tortuous drafting in both public disclosure and legal opinions.

Beneficial ownership through ADRs

Another aspect of the second *HSBC* decision was less welcome. Responding to an alternative line of argument put forward by the taxpayer, the FTT concluded that, on the facts of the case, it was not satisfied that the holder of an ADR was the beneficial owner of the underlying shares. The rights of ADR holders, the court considered, were merely contractual and did not give rise to any trust or other beneficial interest. This decision was contrary to established market practice and initially raised concerns on matters including the tax treatment of dividends and capital gains and the availability of tax credits and rollover reliefs. Many US lawyers expressed surprise at the expert witness evidence on the effects of the underlying New York law documentation, on which the FTT's finding of facts was based.

Thankfully, HMRC has taken a pragmatic approach. In guidance published in *Business Brief 14/12* and para CG50240 of its *Capital Gains Manual*, HMRC indicated that it will continue to apply its longstanding practice of treating an ADR holder as having a beneficial interest in the underlying shares, except in cases where it may be conclusively determined under overseas law that there is no beneficial ownership. As a result, these practical concerns have largely subsided.

This all nevertheless demonstrates the importance of paying close attention to the details of an ADR programme. Extra care should be taken about whether ADRs may be 'pre-released' (in other words, if ADRs may be issued before the depositary acquires the relevant underlying shares, as was the case on the facts of the second *HSBC* case). Thought should also be given as to whether public disclosure nods to any residual uncertainty on beneficial ownership, perhaps through a reference to HMRC practice. Also, don't forget the notification obligations under FA 1986 s 68.

See also the articles 'ADRs, beneficial ownership and HSBC' (Graham Iversen) *Tax Journal*, dated 22 June 2012 and 'Where are we now on ADRs?' (Sara Luder) *Tax Journal*, dated 27 July 2012.

HMRC seems to apply its 'integral' test quite broadly

The future: direct trading

A new alternative to ADRs has emerged: the phenomenon of UK shares traded directly on the US markets.

Aon, Rowan and Ensco were early examples. In some cases, a significant driving factor was eligibility for inclusion in the S&P 500 index following an 'inversion' transaction. (Directly traded UK shares are eligible for inclusion in the S&P 500, but shares traded through ADRs are not.) Liberty Global is a more recent 'inversion' transaction which took this route, while the recent IPO of Oxford Immunotec is, the authors believe, the first example of a pre-existing UK group floating with shares trading directly on US markets. Other potential deals are in the pipeline. As a result of these transactions, shares in UK companies are now traded directly on both NYSE and NASDAQ.

How does direct trading work, and what is the stamp duty position?

Similarly, in some respects, to the way that shares traded on the London Stock Exchange are held through CREST, shares traded on the relevant US exchanges are held by a nominee for the Depository Trust Company (DTC). As regards stamp duty, the similarity ends there however. CREST is not a clearance service for stamp duty and SDRT purposes, but DTC is. It follows that UK shares held within DTC can be transferred free of SDRT, as a result of the exemptions in FA 1986 s 90(4), (5). It is understood that DTC has not made any election under FA 1986 s 97A to disapply these exemptions, but parties to a live transaction may wish to seek their own confirmation on this point directly from DTC.

How do the shares make their way into DTC? Following the *HSBC* decisions, it might have been assumed that a direct issue of shares to DTC would

'Inversion' transactions

A UK company may be listed in the US in consequence of an 'inversion' transaction. These involve US-based groups 'inverting', so as to be headed by a non-US parent company. By inverting, and then expanding operations held outside the US, or even transferring existing operations out from beneath US entities, a US-based group may be able to mitigate certain disadvantages of the US tax system, including the worldwide basis of tax and the subpart-F CFC rules. Anti-avoidance rules in s 7874 of the US Internal Revenue Code and associated regulations restrict the ability to carry out tax effective inversion transactions. However, inversion through merger with a substantial non-US group remains possible (although this would become more difficult if the US administration's recent Budget proposal were to be adopted). Last year's merger of Liberty Global with Virgin Media under a UK holding company is an example of this.

See also 'US inversions through European mergers' (Tim Sanders and Eric Sensenbrenner) *Tax Journal*, dated 28 June 2013.

Direct trading: simplified steps for putting shares into DTC

1. Shares are issued to nominee for depositary receipts issuer, which is incorporated outside EU. Depositary receipts issuer issues depositary receipts to beneficial owners of shares. No SDRT, following *HSBC*.
2. Depositary receipts are cancelled. Underlying shares are transferred to nominee for DTC. This is an exempt inter-system transfer within FA 1986 ss 72A and 97B. Because the depositary receipts issuer is incorporated outside EU, FA 1986 s 97C does not apply. Beneficial owners are recognised as holders of shares through DTC's book entry system.
3. Shares transferred by book-entry within the DTC system. No SDRT by virtue of FA 1986 s 90(4), (5) (assuming no s 97A election).

A new UK holding company

A new UK holding company may be established in connection with a US listing. Reasons may include:

- Redomiciliation to the UK of a group currently outside the UK.
- Restrictions on the reregistration of a limited company as a PLC under CA 2006 s 92.
- Reserves planning.

Tax issues include:

- Rollover treatment for shareholders, including for employees holding restricted shares (for whom the Finance Bill changes are a helpful development).
- Cancellation scheme of arrangement to mitigate stamp duty costs – don't forget to obtain HMRC confirmation that the court order sanctioning the scheme will not attract stamp duty.
- Consider other clearances, including under the transactions in securities legislation.
- Effect of change of ownership on carry forward of losses – see the proposed Finance Bill changes (see 'Draft FB 2014: Losses on a change of control' (Sara Luder) *Tax Journal*, dated 21 February 2014).
- Is a subsequent transfer of shares in the new holding company an integral part of a raising of capital?

raise few difficulties from a stamp duty perspective. This is not, however, the approach which has been taken. Instead, for a number of practical reasons, shares have initially been put into a depositary receipts system, before being transferred across to DTC (see box above). Any subsequent deposit of shares would follow the same route (so, if shares were removed from DTC, so as to be held in certificated form, but it was then wished to put them back into DTC, the re-entry would need to be via the depositary receipts system).

Practical points to consider include the following:

- DTC is likely to require that transaction-specific clearances are obtained from HMRC.
- Future stamp duty savings and the wider benefits of direct trading in the US markets need to be weighed against the cost of obtaining clearances and legal opinions, together with the fees charged by all entities in the structure.
- The stamp duty treatment of stabilisation arrangements needs to be considered carefully.
- Standard US style transaction documents, which may look unfamiliar to UK tax lawyers, are likely to require modifications in order to allocate residual risks appropriately.
- Again, bear in mind the notification requirements under FA 1986 ss 68 and 71.

The attractions, though, are clear. Shares in a UK company can now be traded on the US markets without any stamp duty cost on transfer or any 1.5% charge having been paid upfront. By contrast, trading the same shares in London would generally give rise to 0.5% SDRT per transfer. With this background, and bearing in mind the potential attraction of US markets to growing UK companies, the forthcoming abolition of stamp duty and SDRT for transfers of shares on AIM and the ISDX Growth Market, effective from 28 April 2014, may be seen less as a boost for those markets, and more as a step towards levelling a playing field which currently slopes away from the UK markets.

Share buybacks

The 0.5% stamp duty charge under FA 1986 s 66(2) on the buyback of a company's own shares should not be overlooked. There is no exemption from this charge for shares held in a depositary receipts system or a clearance service. This may be particularly significant for UK companies listing in the US, as share buybacks tend to be more common in the US than in the UK. This is one area where the stamp duty position of UK companies listing on AIM or the ISDX Growth Market will soon be preferable to that of US companies listing in the US, thanks to a proposed new exemption for buybacks – although significant returns of capital by 'growth' companies may in practice be unlikely.

Other issues

Other issues relevant to a group considering whether to list a UK company in the US may include the following:

- UK residence may be attractive to international groups, including US groups looking to 'invert'. Readers will be familiar with the benefits of the dividend exemption, substantial shareholdings exemption, reformed CFC rules, comparatively low corporate tax rate, patent box regime, good treaty network and no withholding on dividends. The attractions of the latter should not be underestimated: the absence of dividend withholding appears, for example, to have been a significant factor behind establishing a UK resident (albeit Netherlands incorporated) holding company on the Fiat/Chrysler merger.
- A transaction involving a listing in the US (or elsewhere) may involve the insertion of a new holding company. This will certainly be the case where a non-UK group is looking to establish a new UK holding company. It may

also be relevant for a group which is already headed by a UK company, for reasons including distributable reserves planning and the company law rule under CA 2006 s 92, which restricts the reregistration of limited companies as PLCs. This will frequently apply to young, growing companies looking to IPO. The insertion of a new holding company will itself raise numerous tax issues (see box opposite).

- The management of corporate tax residence is unlikely to be problematic for a UK incorporated company listed in the US. Even if directors and the making of decisions gravitate towards the US, the US system of establishing residence solely by reference to the place of establishment (except in 'inversion' situations), rather than also by reference to management and control, means that a UK incorporated company should not acquire US residence or lose its UK residence. By contrast, if UK residence is sought for a company incorporated outside the UK (in Jersey, for example), real practical difficulties may arise if directors based in the US are reluctant to travel to the UK.
- Another benefit of using a UK incorporated holding company, rather than a company incorporated offshore but resident in the UK, is access to certain EU law rights (which may depend on incorporation within a member state).
- For a large group intending to list in both the UK and US, UK incorporation may also be a factor relevant in determining eligibility for FTSE index inclusion.
- The exposure of US market investors to UK inheritance tax may potentially be a concern, and it may need to be considered how the analysis for ADRs compares with that for directly traded shares. The 1978 US/UK Estate and Gifts Tax Treaty will in many cases provide assistance. For a company deciding between floating on the US markets or on AIM, the availability of relevant business property relief for 'unquoted' shares may be a marginal factor in favour of AIM.
- Situs for capital gains purposes may also need to be considered. A UK holding company may be unattractive to a UK resident non-domiciled individual holding a material stake in the group. The place of incorporation may also potentially affect the exposure of a non-resident trading in the UK to UK tax on chargeable gains in connection with the shares.

There are, of course, many considerations besides tax issues for a UK company seeking a US listing for its shares. Filing and regulatory requirements and the likely relevance of the takeover code will be high among these, and US investors may be surprised at some of the differences between UK and Delaware company law. ■

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US inversions through European mergers (Tim Sanders and Eric Sensenbrenner, 28.6.13)

ADRs, beneficial ownership and HSBC (Graham Iversen, 22.6.12)

Special report: Key US tax issues (multi-author report, 27.7.12)