

Tax

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Hong Kong Tax Analysis

Court of Appeal rules vesting of Hong Kong stock by operation of merger law not chargeable with stamp duty

Hong Kong's Court of Appeal (CA) released its decision on *Nomura Funds Ireland Plc v. The Collector of Stamp Revenue [2021 HKCA 1040]* on 21 July 2021. The case concerns whether the transfer of Hong Kong stock arising from a foreign merger is chargeable with stamp duty.

The issue of stamp duty on merger transactions has lacked clear guidance. This is probably the first Hong Kong court case to confirm that vesting of Hong Kong stock on a merger effected by the operation of transmission by law is not subject to stamp duty. The case is a good reference for mergers of foreign companies holding Hong Kong stock or immovable property.

This *Tax Analysis* summarizes the facts of the case and highlights the reasoning behind the judgment.

Background

The duty payer is an investment company incorporated in Ireland (Nomura Ireland) that is structured as an umbrella fund of different sub-funds, including the Nomura Funds-China Fund (the Receiving Sub-fund).

Nomura Funds was another investment company incorporated in Luxembourg (Nomura Luxembourg), with just one sub-fund, Nomura Funds-China Opportunities (the Merging Sub-fund), and investments consisting entirely of securities listed on Hong Kong Stock Exchange (HK stock).

Nomura Ireland and Nomura Luxembourg proposed to merge the Merging Sub-fund into the Receiving Sub-fund. The draft terms of the proposed merger were set out in a Common Merger Proposal (CMP) instrument. This stated that the Merging Sub-Fund would be merged into the Receiving Sub-Fund in accordance with Luxembourg law, under which the merger would be subject to the competent authority's approval. According to the CMP, when the merger was effected, *the Merging Sub-fund would transfer all of its assets and liabilities to the Receiving Sub-Fund as a contribution in specie, in exchange for shares in the Receiving Sub-Fund.*

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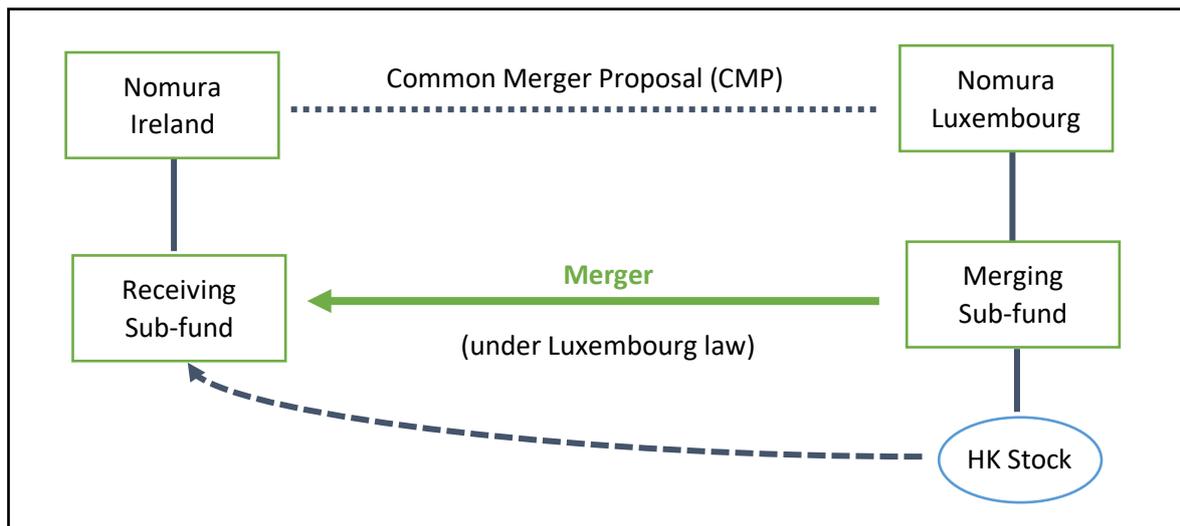
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The merger took effect, and the investments of the Merging Sub-Fund, including HK stock, were transferred¹ to the Receiving Sub-Fund. Nomura Luxembourg was deregistered.



The dispute

Nomura Ireland claimed relief from stamp duty with regard to the vesting of HK stock in the Receiving Sub-fund. In correspondence with the Collector of Stamp Revenue (the Collector), Nomura Ireland provided two legal opinions issued by Luxembourg legal experts that concluded the merger and transfer of HK stock occurred "by operation of law" (i.e. Luxembourg law) rather than the CMP.

However, the Collector was of the view that the transfer of HK Stock was effected "in accordance with law", not by operation of law, meaning it was the CMP that effected the transfer of HK stock, which made the transfer subject to stamp duty.

Decision of the District Court

Nomura Ireland appealed to the District Court, which upheld the Collector's position and refused to accept the two legal opinions, saying they were inconsistent with each other and lacked legal analysis. It interpreted Luxembourg law and determined it was the CMP that had implemented the merger and the transfer of the beneficial interest in HK stock. Hence, the CMP should be chargeable to stamp duty. The duty payer then appealed to the CA.

Decision of the CA

The CA overturned the lower court's decision and held in favour of the duty payer, concluding that the CMP was not chargeable with stamp duty as the transmission of HK stock was by way of universal succession and therefore not effected by the CMP. The reasons for the judgment and decision on interest are as follows:

Acceptance of the legal opinions

The CA said the lower court erred in its reasons for not accepting the legal opinions, concluding these were not inconsistent and that the Luxembourg legal experts had provided clear, cogent reasons in support of their views as understood under Luxembourg law. It accepted that the CMP was merely a regulatory document required under Luxembourg law to be submitted to the competent authority for approval, and did not give effect to the transfer of assets and liabilities upon such approval.

¹ Per the background section of the CA judgement (paragraph 14)

Universal succession by law

The CA considered that the true substance of the vesting of HK stock amounted to a transmission or universal succession by law. Pursuant to Luxembourg law, upon approval of the merger, all assets and liabilities of the Merging Sub-fund would vest in the Receiving Sub-fund, and the Merging Sub-fund would cease to operate. This met the essential criteria of a universal succession by law despite "transmission" or "universal succession" not being mentioned in the Luxembourg law.

The CA therefore concluded that the vesting of HK stock was effected through operation of transmission by law but not by any written instrument (including the CMP), and the CMP did not need to be stamped as it fell outside Head 2(3) of the First Schedule of the Stamp Duty Ordinance (SDO).

No interest on refund of stamp duty

After the hearing, Nomura Ireland requested interest on the refund of the stamp duty paid. The CA rejected this request on the grounds that the statutory intent is not to give interest on any ordered refund to a duty payer who succeeds in challenging their assessment on appeal. Instead, there is a complete, exhaustive appeal regime and circumstances in which payments of stamp duty wrongly assessed may be recovered. There is also a mechanism under which a duty payer intending to appeal their assessment may ask to postpone payment of the assessed duty by providing satisfactory security (which could be interest bearing) to the Collector, to protect their effective out of pocket position.

Our observations

This case is a good reference for mergers of foreign companies holding Hong Kong stock or immovable property. Regarding merger law in Hong Kong, the Companies Ordinance has provided the legal framework for two or more companies within a group to amalgamate and continue as one company without the involvement of the courts since March 2014. The Inland Revenue Ordinance was amended earlier this year to codify the tax treatment of court-free amalgamations. However, there was no amendment to the SDO.

The government once expressed its view in a Bills Committee meeting that the succession of assets of an amalgamating company by the amalgamated company is by operation of law. Therefore, no stamp duty should arise because under a court-free amalgamation, no instrument is to be executed for the succession of assets. We suggest the Inland Revenue Department state this view through its website or Stamp Office Interpretation and Practice Notes to provide clearer guidance to taxpayers.

There are two points to learn from this case. It is not uncommon for taxpayers to obtain legal opinions to support their contentions in matters involving foreign law. This case shows that a court may not simply accept any stated expert opinion based on foreign law, but will look at the basis of the legal reasoning and foreign statutory provisions in determining what weight to give the opinion. A foreign law expert should set out not only the conclusion, but also the source materials, legal principles, and the reasoning leading to their conclusion.

Unlike profits tax, a stamp duty payer, on successful appeal, is not entitled to interest on the refund of stamp duty. Stamp duty payers should be aware of this when pursuing an appeal because the stamp duty paid could be held up for a long period of time without interest being awarded.

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