



**TC01858**

**Appeal number: TC/2009/16584**

*SDRT – acquisition of target company as part of which overall transaction shares issued to exchange agent on trust for target’s ex-shareholders and subsequently ADRs issued to target’s ex-shareholders - whether SDRT charge on transfer of shares to issuer of ADRs was unlawful under the Capital Duties Directive and/or the Treaty – no reference to CJEU – appeal allowed*

**FIRST-TIER TRIBUNAL  
TAX CHAMBER**

**HSBC HOLDINGS PLC**

**-and-**

**THE BANK OF NEW YORK MELLON  
CORPORATION**

**Appellants**

**- and -**

**THE COMMISSIONERS FOR HER MAJESTY’S  
REVENUE & CUSTOMS**

**Respondents**

**TRIBUNAL: JUDGE BARBARA MOSEDALE  
ANNE REDSTON**

**Sitting in public at Bedford Square, London on 20-24 June 2011**

**I Glick QC, D Jowell QC and C Patton, Counsel, instructed by Norton Rose LLP for the Appellants**

**J Swift QC, P Mantle and T Lall, Counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents**

## DECISION

1. HMRC issued two notices of determination under Regulation 6 of the SDRT regulations on 13 November 2009 rejecting claims made by the two Appellants on 17 April 2009 for repayment of SDRT of £66,178,472.03 paid to HMRC between 7 May 2003 and 15 October 2003 (with interest) in respect of the transactions outlined below. The first notice of determination was issued to HSBC Holdings PLC (“HSBC”) and the second to The Bank of New York Mellon Corporation (“BNY”).

### 10 **Agreed issues**

2. The parties were agreed that the following were the principal issues for determination by the Tribunal:

15 1. Were the relevant charges to SDRT under s93 contrary to the provisions of Article 11 of the council Directive 69/335/EEC (as amended) or were they permitted by Article 12 of the Directive?

2. Were the SDRT charges in this appeal contrary to the provisions of Article 10 of the Directive or were they permitted by Article 12 of the Directive?

20 3. Were the SDRT charges incompatible with any relevant applicable right of either Appellant under Article 56(1) of the EC Treaty?

3. Both parties considered that there were subsidiary issues which first needed to be determined before the principal issues could be resolved, most importantly whether the transfer of the HSBC shares to the depositary on which the SDRT was charged was a transfer of bare legal title only, beneficial title being retained by the investors.

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4. We deal with the following issues in this decision notice:

#### **The facts**

##### **General**

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##### **The law**

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## The facts

5. There was an agreed statement of facts, dated 18 May 2011, which we largely rely on for the following summary of what happened. In addition we rely on the evidence we heard and the documents which were produced to the Tribunal to make the following findings of fact.

6. HSBC is a well-known financial institution registered in the UK, and with its shares traded on the London, Paris and Hong Kong stock markets. Because it is not registered in the US, its shares are not (and cannot be) traded on the New York Stock Exchange. Instead, HSBC sponsored an American Depositary Receipt (“ADR”) programme and HSBC American depositary shares were listed on the New York Stock Exchange from July 1999. Each HSBC ADR represents 5 HSBC ordinary shares of US\$0.50 each.

### *The HSBC ADRs*

7. The contract governing the issue of HSBC ADRs was set out in a tripartite Deposit Agreement. The original version was dated 22 March 2001, but it was amended on 27 March 2001 and 28 March 2003. The parties to the Deposit Agreement were HSBC, who issued the shares, BNY, who acted as depositary of them and issued the HSBC ADRs, and the holders of the HSBC ADRs. (Technically, BNY issued American depositary shares, which were evidenced by American depositary receipts, as we explain in more detail in paragraph 95. Nothing turns on this in the appeal and we refer to the security issued by BNY as an ADR).

8. The Deposit Agreement envisaged that the HSBC shares would actually be held by a custodian which would be the London Branch of BNY or an alternative. In so far as the ADRs in this appeal are concerned, under the Agency Agreement (see paragraph 27 below) all the HSBC shares to back the ADRs were transferred to BNY Nominees Ltd (“BNY Nominees”), a UK company which was a wholly owned subsidiary of BNY.

9. Ordinarily, BNY would issue ADRs in return for the deposit with its custodian (BNY Nominees) of HSBC shares. However, clause 2.10 of the Deposit Agreement enabled BNY to ‘pre-release’ ADRs. This meant that BNY was entitled to issue ADRs without possessing at the time the HSBC shares deposited with BNY or its nominee. The clause provided that in ordinary circumstances ADRs issued but not backed by HSBC shares should not exceed 30% of the ADRs in issue:

“the number of Shares not deposited but represented by American Depositary Shares outstanding at any time as a result of Pre-Releases will not normally exceed thirty percent (30%) of the Shares deposited hereunder.”

In order for the pre-release to take place, it had to be “fully collateralized with cash or other collateral as the Depositary deems appropriate” and such collateral was to be held by BNY to ensure that the “pre-releasee” fulfilled its obligation to deliver the shares at the end of the pre-release period.

10. There was no difference between the rights of an ADR holder who had been issued its ADRs under pre-release and any other ADR holder. They could (and some did in the transaction giving rise to this appeal) “break” the ADR during the pre-release period and ask for and receive delivery of HSBC shares.

5 *The merger*

11. Household International Inc (“Household”) was a company incorporated under the laws of the State of Delaware, USA. Its shares were registered on the New York Stock Exchange.

10 12. HSBC formed a subsidiary company, H2 Acquisition Corporation (“H2”), to acquire the entire issued share capital of Household. Like Household, H2 was a company incorporated under the laws of the State of Delaware USA. The acquisition of Household by H2 was to take place as a merger under the laws of Delaware.

15 13. HSBC, H2 and Household entered into an agreement (“Merger Agreement”) on 14 November 2002 under which the merger was agreed subject to certain conditions precedent, such as the agreement of both Household stockholders and HSBC shareholders.

20 14. On 28 March 2003, both the Household stockholders and HSBC shareholders voted in favour of the merger. On the same day the Board of HSBC approved the merger. The merger legally took place at 10.02 pm on 28 March 2003. Late that day, a certificate of merger was filed with the Secretary of State of Delaware in accordance with that State’s laws.

15. Under US law and the terms of the Merger Agreement, the effect of the merger between Household and H2 was that Household’s separate legal existence ceased, its shares were cancelled and all its assets and liabilities then belonged to H2.

25 16. Under the terms of the Merger Agreement, all Household’s issued shares were converted into the right to receive HSBC shares, at the rate of 2.675 HSBC shares for each Household share. For the Household stockholders, it would have had the appearance of a share for share exchange (although in US law it was a merger and H2 did not actually acquire shares in Household). Under the terms of the agreement, each  
30 Household shareholder was also given the right to elect to have, instead of the HSBC shares, HSBC ADRs, at the rate of 0.535 HSBC ADRs per Household share. It was a term of the Merger Agreement that HSBC would appoint an exchange agent to administer the exchange: the exchange agent was to be BNY or another agent “reasonably acceptable” to Household.

35 17. The reason the option for ADRs was given is that many Household stockholders were US citizens who would find it preferable to hold securities which could be traded on US stockmarkets: HSBC ADRs could be traded on a US stock market (as they were securities issued by an American bank) but HSBC shares could not be so traded.

18. The allotment by HSBC of 1,273,297,057 new US\$0.50 shares (“the new HSBC shares”) consequent on the Merger Agreement increased its share capital by 13.43%. The allotment took place on 28 March 2003 and became unconditional before trading commenced: these shares were admitted to trading on the London Stock Exchange on 31 March 2003.

19. In the event, the Computershare Trust Company of New York (“CTCNY”) was chosen to be the exchange agent. CTCNY was a trust company incorporated under the laws of the State of New York whose business was offering custodian services and acting as an exchange agent. The allotment of the 1,273,297,057 shares referred to in the above paragraph was therefore to CTCNY as nominee for the former Household stockholders. The Exchange Agency Agreement, dated 28 March 2003, which was between CTCNY, HSBC and Computershare Investor Services Plc (“CIS” – see paragraph 34 below) provided (clause 1.1) that CTCNY held the shares “as Exchange Agent for the benefit of Household Common Stockholders .... on bare trust as custodian.” The beneficial ownership of the shares was therefore with the former Household stockholders.

20. On 3 April 2003, the former Household stockholders were sent an election form which gave them the power to opt no later than 28 September 2003 to receive their HSBC shares (at the agreed rate of 2.675 ordinary shares per Household share) or to receive HSBC ADRs (at the agreed rate of 0.535 per Household share). If no election was made by this date, the former Household stockholder was deemed to have elected to receive the HSBC shares.

21. As and when CTCNY received an election for ADRs from a former Household stockholder for HSBC ADRs, BNY (under the terms of the Agency Agreement between it and HSBC on 3 April 2003 discussed in more detail below) issued to that stockholder the correct number of HSBC ADRs. If, however, the former Household stockholder elected to receive HSBC shares, then HSBC shares were transferred to it by CTCNY. No tax was charged in this latter event and it is not relevant to this appeal.

### 30 *The flowback arrangements*

22. It was HSBC’s experience in a similar, previous transaction that many ADRs issued following a share for share type exchange would be sold very quickly by the target company’s ex-stockholders and often sold to institutional buyers who would rather hold the underlying shares than the ADRs (for reasons explained below in paragraph 106). Such institutional buyers would, therefore, on buying the ADRs from the ex-stockholders, immediately cancel them and ask for the transfer to them of the underlying HSBC shares.

23. However, SDRT under s 93 Finance Act 1986 (“FA 86”) (set out below in paragraph 151) was chargeable only on the issue of an ADR and not on the issue of a share. Where the newly issued ADRs were cancelled within a few days or weeks of issue as the holder preferred to own the shares, HSBC regarded the SDRT as double taxation: the rationale for SDRT was to tax the issue of an ADR as, unlike transfers

of shares, transfers of ADRs were not taxed. Where the ADRs were cancelled soon after issue, both SDRT would be payable on issue *and* stamp duty would be payable on future transfers.

5 24. The flowback arrangements were devised to utilise BNY's ability to pre-release the ADRs (as set out in paragraph 9 above) before the deposit of the shares with BNY. This, it was thought, avoided an SDRT liability on ADRs cancelled within the flow back period because the shares backing the ADRs would never be deposited with BNY Nominees and the chargeable event would never occur in respect of those shares.

10 25. Only where the ADRs were not cancelled within the flowback period and the underlying shares actually deposited with BNY Nominees would SDRT be paid.

15 26. The Exchange Agency Agreement mentioned in paragraph 19 above was intended to put this flowback arrangement into place. Under this agreement, CTCNY had to transfer HSBC shares to the former Household stockholders who elected to receive them; to transfer HSBC shares to holders of ADRs who cancelled them during the flowback period and at the end of the flowback period transfer the balance of shares in respect of which ADRs had been issued to BNY Nominees.

20 27. HSBC also entered into the Agency Agreement with BNY dated 3 April 2003 referred to above in paragraph 21 under which (in brief) BNY agreed to pre-release ADRs and HSBC agreed to ensure that CTCNY would transfer the appropriate number of HSBC shares to BNY Nominees under the flow back arrangements. To the extent there was a shortfall, HSBC agreed to compensate BNY in US dollars sufficient to purchase on the market the necessary number of outstanding HSBC shares at the end of the flow back period to back the ADRs issued as pre-releases.  
25 This was the collateral provided as mentioned in paragraph 9 above.

30 28. We find that there was nothing in the Merger Agreement to presage the flowback arrangements, which is as expected as the flowback arrangements were not in fact devised until after the Merger Agreement was entered into. It was not a term of the Merger Agreement that CTCNY be appointed as exchange agent: as mentioned above the Merger Agreement contemplated that BNY would be the exchange agent or some other agent "reasonably acceptable" to Household. HSBC was contractually liable to give the former Household stockholders the right to elect between shares and ADRs and of course to ensure that they received shares or ADRs in accordance with their election. Under the terms of the Merger Agreement HSBC did not need to fulfil  
35 its contractual liabilities in the manner in which it did: it could, for instance, have issued all the shares to BNY Nominees instead of to CTCNY and used BNY as the exchange agent as indeed it seems was originally contemplated. The transfer of HSBC shares by CTCNY to BNY Nominees was not contemplated by the Merger Agreement. We revert to the relevance of this in paragraphs 213-219.

40 29. The first flowback period ended on 1 May 2003. At the end of it CTCNY deposited with BNY Nominees HSBC shares to the extent that CTCNY had received an election for ADRs which BNY had then issued but only to the extent that those

ADRs had not been subsequently cancelled. In the event, this led to 591,169,630 HSBC shares being deposited with BNY Nominees by CTCNY on 2 May 2003.

30. The former Household stockholders had until 28 September 2003 to make their election, and as HSBC was concerned that it had not had as many elections for ADRs as it would have expected at the end of the first flowback period, another flowback period was agreed between BNY and HSBC to run from 12 May to 9 June 2003. Under this agreement CTCNY transferred to BNY Nominees HSBC shares at the end of 9 June to the extent that CTCNY had received an election for ADRs on or after 12 May (the start of the second flowback period) which it had issued but only to the extent that those ADRs had not been cancelled. For the same reason a third flowback period, to 8 July 2003, was agreed.

31. In the event, some 902,770 shares were deposited with BNY Nominees on 10 June at the expiry of the second flow back period. A further 4,411,530 shares were deposited with BNY Nominees on 9 July at the expiry of the third flowback period.

32. 11,498,373 shares following elections made between the first and second flowback periods and a further 37,087,610 shares following the expiry of the third flowback period were also deposited with BNY Nominees by CTCNY.

33. In total some 645,069,915 HSBC shares were transferred by CTCNY to BNY Nominees under the arrangements outlined above and the parties were agreed that under the provisions of s93(1) FA 86 SDRT at the rate of 1.5% was chargeable on these transfers.

34. For completeness, we mention that the third company which was party to the Exchange Agency Agreement, CIS, was a UK registered company which offered registrar and share custodian services. It maintained the register of shareholders of HSBC and under the Exchange Agency Agreement maintained the account of shares held by CTCNY for the benefit of former Household stockholders, and, as agent for CTCNY, transferred the appropriate number of shares to BNY Nominees at the end of the flowback period. As CIS had neither beneficial nor legal title to the shares, we do not mention it again.

### 30 *HMRC clearance*

35. HSBC sought advance clearance from HMRC for the tax treatment of shares under the flowback period. The original clearance from HMRC was dated 20 January 2003 and given by Mr Harwood, an officer of HMRC:

35 “I am pleased to confirm my acceptance of your client’s proposals for dealing with the ‘flow back’ of HSBC shares as a consequence of the cancellation of ADSs issued to former shareholders of Household International. The higher rate SDRT charge will only therefore apply to the transfer by the exchange agent of the balance of the consideration shares to the depositary’s bank nominee following the cessation of the flow back, which I understand will be no later than 20 business days after the issue of the letters of transmission.”

HMRC gave clearances on the two later flowback agreements on 9 May 2003 and 10 June 2003 respectively.

5 36. As agreed with HMRC, HSBC therefore paid SDRT at 1.5% on the value of shares by reference to the closing price of HSBC ordinary shares in London on the day immediately prior to the date on which the net balance of HSBC ordinary shares was deposited with BNY as Depositary. In other words, SDRT was paid on the basis the chargeable event was the transfer by CTCNY to BNY Nominees (and not the issue by HSBC to CTCNY), as indeed it was (see paragraph 155).

10 37. In total, HSBC paid £66,178,472.03 in tax between 7 May 2003 and 15 October 2003 arising out of the arrangements described above.

### **Retention of beneficial ownership of the HSBC shares?**

15 38. The parties did not agree on who was the beneficial owner of the HSBC shares at the point an election was made to receive ADRs and the former Household stockholder were issued the ADRs. The issue is relevant to the appeal because it was the Appellants' case that when CTCNY transferred the shares to BNY Nominees it was merely transferring the shell of the legal title, the beneficial ownership having been retained by the former Household stockholders who became the ADR holders.

20 39. If the Appellants were right about this, it is their case it impacts on the questions of law to be determined by this Tribunal. Firstly, although the Appellants did not really put this point forward, there is an argument that if the transfer from CTCNY to BNY Nominees was merely of bare legal title then SDRT should not have been charged as a matter of UK law. We consider this below in paragraphs 161-165 where we consider FA 86.

25 40. Secondly, and advanced more strongly by the Appellants, was the case that SDRT on the *transfer* of bare legal title which was integral to the earlier acquisition of the beneficial title on *issue* of the HSBC shares would fall foul of Articles 10 and 11 of the Capital Duties Directive and not be relieved under Article 12.

30 41. In more detail, their proposition was that the former Household stockholders obtained the beneficial interest in the HSBC shares at the moment that the shares were issued to CTCNY. It is the Appellants' case that the former Household stockholders who elected for ADRs retained this beneficial interest so that there was no subsequent transfer of the beneficial interest in these shares. They say that the only subsequent transfer in respect of these shares was the transfer by CTCNY of the bare legal title to BNY Nominees. Therefore, say the Appellants, by taxing this mere formality, this transfer of the shell of legal ownership, this amounted to a tax on the grant to those former Household stockholders of the beneficial interest in the HSBC shares which they obtained when the shares were issued to CTCNY as trustee.

40 42. We consider this legal argument below in paragraphs 274-279 when we come to consider the Capital Duties Directive. It was also the Appellants' position that even if they were wrong about the former Household stockholders retaining beneficial title,

nevertheless the SDRT charge was still unlawful under EU law. But at this point in the decision notice we consider whether the Appellants were right to say that the beneficial ownership of the HSBC shares remained with the former Household stockholders who elected for ADRs from the moment of the allotment of the HSBC shares to CTCNY onwards until after the issue to them of the ADRs.

*Retention of beneficial interest as a matter of fact*

43. For the Appellants to be right that the former Household stockholders retained the beneficial interest in the HSBC shares, they have to satisfy this Tribunal on two quite distinct points:

- 10 (1) Firstly, they have to demonstrate that the holders of HSBC ADRs are the beneficial owners of the deposited HSBC shares;
- 15 (2) But even if they can show this, in addition they have to show that the former Household stockholders, on becoming ADR holders, *retained* the beneficial interest that they already held in the HSBC shares when legal title to them was with CTCNY. This means the Appellants have to show that the former Household stockholders as owners of ADRs held the *same* beneficial interest that they held when legal title to the HSBC shares was with CTCNY.

44. We consider question (2) first. The question of whether the holders of an ADR held what in English law would be described as a beneficial interest in the underlying shares is a matter of US law as the ADRs were issued by an American Bank, in America, under a contract (the Deposit Agreement) governed by the law of the State of New York. For this tribunal, it is therefore a question of fact. We consider the nature of this interest (if it existed) below in paragraphs 53-55.

45. The question of whether the holders of the ADRs had retained this interest (if it existed) since the issue of the shares to CTCNY depends on the nature of the interest they had when the HSBC shares were issued to CTCNY, and this issue was governed by the Exchange Agency Agreement. We go on to consider this aspect first.

*The nature of proprietary interests of the beneficiaries of the CTCNY trust*

46. As mentioned above in paragraph 19, it was a term of the Exchange Agency Agreement, dated 28 March 2003, that CTCNY held the newly issued HSBC shares “as Exchange Agent for the benefit of Household Common Stockholders .... on bare trust as custodian.” The beneficial ownership of (or proprietary interest in) the shares was with the former Household shareholders.

47. Unlike the other contracts in this appeal, the Exchange Agency Agreement was governed by English law (clause 16). As it was governed by English law, technically the agreed fact between the parties that the beneficial ownership of the HSBC shares was with the former Household shareholders was a question of law which it is for this Tribunal to determine. However, we agree that the proper interpretation of the Exchange Agency Agreement, bearing in mind the overall circumstances of the

transaction, must be that CTCNY held the HSBC shares issued to it on trust for the former Household stockholders up to the point that they elected for and received either legal title to the HSBC shares or the ADRs. (With respect to the flow back periods, there is an additional question of who was the beneficial owner of the shares  
5 *after* the stockholders received their ADRs but before CTCNY transferred the HSBC shares to BNY Nominees and we address this issue in paragraphs 73-78).

48. We raised a question at the hearing whether the trust held by CTCNY was truly a *bare* trust in that no individual beneficiary would be able to look through the trust and identify any particular HSBC share as belonging to them. It was conceded by the  
10 Appellants that it was the case that the former Household stockholders could not at the point the shares were held on trust for them by CTCNY identify any particular HSBC share as belonging to them and that their beneficial interest was therefore in an undivided fund (or fungible bulk, to use the US terminology).

49. Although this point was conceded, it was a fairly important point, so we consider  
15 whether it was rightly conceded and we think it was. Take as an example the hypothesis that CTCNY (quite unlike its actual behaviour of course) sold half of the HSBC shares in breach of trust and for whatever reason neither the shares sold nor the proceeds of sale could be recovered. Would half of the former Household stockholders be able to identify that the remaining half of the fund belonged to them  
20 to the detriment of the other half of the former Household stockholders? Clearly they could not as they could not identify any particular share as belonging to them. So the legal position, were such an unlikely eventuality to have occurred, would be that all the former Household stockholders would be able to share equally in the remaining fund and would receive half of what they were entitled to receive. The interest of  
25 each former Household stockholder was therefore a proprietary interest in an undivided fund or fungible bulk.

50. No beneficiary could point to a particular share and say “that one is mine” but on the other hand, if any particular beneficiary wished to terminate the trust, he could (and many did) demand an immediate transfer to it of the number of HSBC shares  
30 equivalent to his beneficial interest. Those transfers are not relevant to this appeal as SDRT was not charged on them. This appeal is concerned with those former Household stockholders who did not elect to receive HSBC shares. We find that they held, from the moment the HSBC shares were issued to CTCNY, a beneficial interest in an undivided fund of HSBC shares proportionate to the number of Household  
35 stocks they had previously held (as mentioned above, in the ratio 2.675 HSBC shares for each Household share).

51. So we find at the point that HSBC shares were issued to CTCNY, the former Household stockholders had a beneficial (or proprietary) interest in an undivided fund of HSBC shares and had the right at any point to call for a transfer to themselves of  
40 the legal interest in the equivalent number of HSBC shares. This was clearly a proprietary interest in a fund of HSBC shares, although not an interest in any particular identifiable HSBC shares.

52. The relevance of this is that the Appellants claim that these former Household stockholders retained *that* beneficial interest up to the moment of and beyond the issue to them of the HSBC ADRs. So in order to continue to answer question (2) posed in paragraph 43 above, we move on to consider the nature of the beneficial interest (if any) of an ADR holder, to help answer the question of whether the former Household stockholders who elected for ADRs retained their pre-existing beneficial interest in HSBC shares.

*The nature of the proprietary interest of an ADR holder (if any)*

53. The Deposit Agreement was governed by the law of the State of New York. We had virtually no evidence on the law of trusts in the State of New York but what we had indicated, as we would expect, that it was very similar to that in England & Wales. We make the assumption that unless we had evidence to the contrary the law of trusts in the State of New York was the same as in England & Wales. From the evidence we received, we find that what we mean by “beneficial ownership” is more likely to be described as a proprietary interest in the law of the State of New York and, to try and avoid confusion with the rather different meaning of “beneficial ownership” given in the US regulatory provisions (described below in paragraph 115), we will use the term “proprietary interest” to mean the equivalent of what “beneficial interest” means in English law.

54. Similarly to the trust fund held by CTCNY, we find that *if* an ADR holder has a beneficial interest in the underlying HSBC shares held by BNY to back the issue of the ADRs (which is question (1) and which we address below), that ADR holder cannot identify any particular HSBC share in which it has a beneficial interest. We find this because it was agreed at the hearing that neither party was advancing the opposite case, and for similar reasons given in respect of the trust held by CTCNY in paragraphs 46-51 above. In any event we find that this must be so as it was clear from clause 2.10 in the Deposit Agreement that in normal circumstances BNY might only hold 70% of the HSBC shares needed to back the ADRs in issue (holding other collateral for the remaining 30%).

55. So that if an ADR holder does have a beneficial interest in the fund held by the issuer to back the issue of the ADRs, it is an interest in an undivided fund or fungible bulk which comprised partly HSBC shares and partly other collateral.

*Was this proprietary interest retained?*

56. The question for this part of the appeal is what happened to the proprietary interests of those former Household stockholders who elected to receive an ADR either outside a flowback period *or* within a flowback period but without cancelling the ADR during that period. Only these two circumstances are relevant as these are the only two situations in which CTCNY transferred HSBC shares to BNY Nominees and therefore the only transfers on which SDRT was charged.

57. It is the Appellants’ case that in both these instances the proprietary interest in the HSBC shares remained with the former Household stockholders. Mr Glick points out

that the rights of the former Household stockholder before making the election for ADRs, and after making that election and receiving the ADRs would be similar: in either case the former Household stockholder could call for the transfer to it of the underlying HSBC shares.

5 58. That is not an answer to the question. The proprietary interest of a beneficiary is, to state the obvious, a property interest. Whether called a beneficial or proprietary interest it is an interest in specific, identifiable property. The question is whether the former Household stockholder retained the proprietary interest which he had in the fund held by CTCNY when he elected for and received his ADRs. The question is  
10 *not* whether his rights under one trust were similar or the same as those under another trust.

59. We have established that the beneficiaries of the CTCNY trust held rights in rem in an undivided fund of HSBC shares. We have established that *if* ADR holders have rights in rem to the deposited shares, it is also an interest in an undivided fund of  
15 HSBC shares and other collateral. Still answering question (2) from paragraph 43 above, the question is whether the former Household stockholder on electing for ADRs retained his beneficial interest.

60. As far as a former Household stockholder who elected to receive ADRs is concerned, one of two things happened. Either he made his election during a  
20 flowback period or he did not. If the election was made outside the flowback period, he would immediately have received the correct number of ADRs in relation to his former stockholding and CTCNY would have immediately transferred the correct number of HSBC shares to BNY Nominees to back those ADRs. If, however, the election was made within a flowback period, as before, the former Household  
25 stockholder would immediately have received the correct number of ADRs in relation to his former stockholding *but* CTCNY would not immediately have transferred any HSBC shares. If the new ADR holder (or more likely, his successor in title) cancelled his ADRs in the flowback period, CTCNY would transfer the appropriate number of HSBC shares to the new ADR holder (or more likely, his successor in title). Such  
30 transfers are of no interest in this appeal as SDRT was not charged on them. However, if the ADR was not cancelled in the flowback period, CTCNY would, at the end of the flowback period, transfer the correct number of HSBC shares to BNY Nominees. SDRT was charged on this transfer.

61. So this appeal is concerned with both:

35 (a) any former Household stockholder who both elected to receive, and then chose not to break, an ADR within a flowback period; and

(b) the former Household stockholder who elected to receive an ADR outside a flowback period.

40 Both of these kinds of former Household stockholder, from the moment the shares were transferred to CTCNY up until the moment they elected for and received their

ADRs, possessed a proprietary interest in an undivided fund of HSBC shares held by CTCNY. Did they retain it on issue of the ADRs?

5 62. We make the point, assuming that an ADR holder does have a proprietary interest in the deposited HSBC shares, that the answer to this question might be different if any particular former Householder stockholder could have identified particular shares in the CTCNY fund in which it held a beneficial interest, and show that these particular shares were then transferred to BNY Nominees to hold on its behalf. But as we have already explained at length, this was not the case.

10 63. We move on to consider what happened to the beneficial interests of those two kinds of former Household stockholders, all the time making the assumption that ADR holders do have a beneficial interest in the deposited shares.

(a) Elections within flowback period

15 64. In respect of those former Household Stockholders who elected to receive ADRs during a flowback period, they received the ADRs some time before CTCNY transferred to BNY Nominees the HSBC shares to back them. Instead, as explained above in paragraph 27, their ADRs were backed by other collateral provided by HSBC under the terms of the Agency Agreement with BNY.

20 65. So even assuming ownership of the ADRs gave the ADR holder a proprietary interest in the underlying fund held by BNY Nominees, that fund (comprising part HSBC shares and part other collateral) did not at that point include any HSBC shares held by CTCNY in which the new ADR-holder had had a proprietary interest at the moment immediately prior to his election. This is because the new ADRs were issued on the basis of other collateral: the whole point of the arrangement was that the HSBC shares held by CTCNY were *not* transferred to BNY to back the issue of the  
25 ADRs until the end of the flowback period.

66. As already mentioned (see paragraph 10 above) the parties were agreed and we find that there was no difference in the rights of an ADR holder issued as a pre-release and those not issued as a pre-release. From the moment of its issue, an ADR under pre-release carried the same rights as any other HSBC ADR.

30 67. It is therefore impossible for such a former Household stockholder to have retained its beneficial interest. It had swapped its proprietary interest in one fund (the fund of HSBC shares held by CTCNY) for a proprietary interest (if any) in another fund (the fund of HSBC shares and other collateral held by BNY Nominees) and at that point in time the assets of the two funds were entirely different in that to the  
35 extent they both comprised HSBC shares, it was not the same HSBC shares.

40 68. By way of footnote to the conclusion in the previous paragraph, we consider that our conclusion is correct even though we recognise that the separate shareholdings of CTCNY and BNY Nominees would each have been held in the CREST system in the UK and been “dematerialised” and unidentifiable by reference numbers. Even though it is our understanding that neither CTCNY nor BNY Nominees would be able to

identify the HSBC shares belonging to themselves by reference to specific identification numbers, nevertheless CTCNY and BNY clearly did not own the same shares.

(b) Elections outside the flowback period

5 69. There were also the former Household stockholders who elected to receive ADRs  
outside any of the flowback periods (see paragraph 32). On making their election,  
they too immediately received their ADRs. But CTCNY would also have made an  
immediate transfer to BNY Nominees of sufficient HSBC shares to underwrite these  
10 ADRs: as it was outside the flowback periods there was no retention of the HSBC  
shares by CTCNY to avoid the SDRT charge and the ADRs were not pre-released.

15 70. Did such former Household stockholders retain their proprietary interest in the  
fund held by CTCNY such that the transfer by CTCNY to BNY Nominees was of the  
bare legal title? Again we do not find in HSBC's favour on this, and for the same  
reason. Up to the point he elected for an ADR, the former stockholder had a  
proprietary interest in the undivided fund of HSBC shares held by CTCNY for the  
benefit of all former Household stockholders who had yet to make an election. If, on  
making the election and receiving his ADRs the new ADR holder obtained a  
proprietary interest in the fund underlying those ADRs and held by BNY Nominees, it  
was a proprietary interest in a *different* fund.

20 71. This is because the fund held by BNY Nominees was held in respect of all HSBC  
ADRs. It comprised shares and collateral (we were not told in what proportion).  
Although we were not informed in what proportion BNY Nominees held "old" HSBC  
shares to newly issued HSBC shares, some of those HSBC shares had been issued or  
transferred to BNY prior to the acquisition of Household. It was a different fund.  
25 This was the case even though a proportion of the shares held would have been the  
same as those in the fund held by CTCNY, because CTCNY immediately transferred  
some of the shares out of its fund to BNY Nominees to back the newly issued ADRs.

30 72. The answer would of course have been very different if the individual ADR-  
holder could identify specific shares held on trust for them: but as we have already  
said, if they had an interest in a trust fund, it was an interest in an undivided fund or  
fungible bulk.

*The black hole*

35 73. Our conclusion is that, assuming ADR holders do have rights in rem to the  
deposited shares, when a former Household stockholder elected to receive an HSBC  
ADR, it gave up its beneficial interest in the fund of HSBC shares held by CTCNY  
and instead received an interest in the different fund of HSBC shares held by BNY  
Nominees for the benefit of all HSBC ADR holders. If ADR holders do not have  
such rights in rem, then the former Household stockholders, on making their  
election for an ADR, gave up their beneficial interest in the fund of HSBC shares held  
40 by CTCNY and received instead just the legal and beneficial title to an ADR.

74. Is our conclusion on this called into doubt by the question of what happened to the beneficial title of those former Household stockholders who made an election during a flowback period to receive ADRs? Mr Swift described this as a “black hole” in the Appellants’ case.

5 75. The Appellants’ view is that the former Household stockholder must have retained the proprietary interest in the fund held by CTCNY during the flowback period but after an election for an ADR, because, they say, no one else was entitled to it and certainly CTCNY was not.

10 76. We agree CTCNY was a trustee: it did not possess a proprietary interest in the HSBC shares. We do not agree that the former Household stockholder retained a proprietary interest in the fund held by CTCNY. We do not agree that on electing for and receiving its ADRs, the former Household stockholder both retained its interest in the CTCNY fund of HSBC shares *and* obtained ADRs. We reject this as it is not in accordance with the contracts or common sense: the former Household stockholders  
15 were entitled to HSBC shares at the agreed rate of 2.675 per Household share **or** the equivalent ADRs. They were not entitled to *both*.

20 77. So what did happen to the beneficial interest in that part of the fund held by CTCNY which, up to the receipt of the ADR, was held by such a former Household stockholder? We do not think that part of the fund was held for BNY who under the Agency Agreement had received (or at least was entitled to receive) collateral in lieu  
25 of the HSBC shares to which it would otherwise be entitled under the Deposit Agreement. The most likely explanation is that that part of the fund was held for HSBC: irrespective of whether this is lawful under company law, this seems to be the case because HSBC had put up the collateral (or at least promised to pay it) to enable  
30 BNY to pre-release the ADRs without holding the HSBC shares (see paragraph 27). And HSBC would have ceased to be the beneficiary when CTCNY transferred the shares to BNY Nominees because at that point HSBC’s obligation to provide collateral to BNY ceased.

35 78. We do not have to conclusively resolve whether at the point *after* an election for an ADR but before the transfer of the legal title to the shares to back those ADRs at the end of the flowback period the shares were held by CTCNY for the benefit of HSBC or BNY (although we think the former the correct answer): all we have to resolve (as we have resolved) is that once the former Household stockholder elected to and did receive his ADR, he no longer had an interest in the fund held by CTCNY.

35 *Conclusion*

40 79. Our conclusion on these rather arcane points is that we cannot accept HSBC’s case that the former Household stockholders who elected for ADRs retained the proprietary interest in the underlying HSBC shares issued to CTCNY. Beneficial title did not remain static with the former Household stockholders who elected to receive ADRs.

80. Nevertheless, we do agree with the Appellants that the legal and beneficial title to the HSBC shares was split and remained split from the moment of the issue of the HSBC shares. We also agree that the transfer from CTCNY to BNY Nominees, on any scenario, was a transfer of bare legal title.

5 81. Our summary of what happened to the split title is as follows:

If ADR holders have rights in rem to the underlying shares then:

10 (1) *on an election outside a flowback period*, at the point that the former Householder stockholder received his ADRs, the beneficial title to the shares transferred by CTCNY to BNY Nominees would have moved from the body of former Household stockholders who still retained a beneficial interest in the remaining fund of shares held by CTCNY to the body of all HSBC ADR holders. We have explained at length that this is because the interests of these beneficiaries would be in an undivided fund and not in identifiable shares;

15 (2) *On an election within a flowback period*, at the point that the former Householder stockholder received his ADRs, the beneficial title to the shares that were to be transferred by CTCNY to BNY Nominees would have moved from the body of former Household stockholders who still retained a beneficial interest in the remaining fund of shares held by CTCNY to HSBC (or possibly BNY) for the reasons explained above. On  
20 the transfer of legal title to BNY Nominees, the beneficial title would move to the body of all HSBC ADR holders.

If ADR holders do not have rights in rem to the underlying shares then:

25 (1) *On an election outside a flowback period*, at the point that the former Householder stockholder received his ADRs, the beneficial title to the shares transferred by CTCNY to BNY Nominees would have moved from the body of former Household stockholders who still retained a beneficial interest in the remaining fund of shares held by CTCNY to BNY (who issued the ADRs and was contractually bound to honour the terms of the  
30 ADR contract);

35 (2) *On an election within a flowback period*, at the point that the former Householder stockholder received his ADRs, the beneficial title to the shares transferred by CTCNY to BNY Nominees would have moved from the body of former Household stockholders who still retained a beneficial interest in the remaining fund of shares held by CTCNY to HSBC (or  
possibly BNY) for the reasons explained above. On the transfer of legal title to BNY Nominees, the beneficial title would move to BNY (who issued the ADRs and was contractually bound to honour the terms of the ADR contract).

**Did the holders of HSBC ADRs have a proprietary interest in the underlying shares?**

82. What is clear, despite the convoluted movements of the beneficial interest, is that the former Household stockholders did not in any of these scenarios retain the beneficial interest they acquired on the issue of the HSBC shares to CTCNY on trust for themselves. It is therefore strictly unnecessary for us to decide whether ADR holders do have rights in rem or only in personam. But in case this appeal goes higher, we must record our findings of fact and so we move on to consider this point.

83. Before considering in detail the Appellants' case that ADR holders do have rights in rem we deal first with their point that HMRC could not advance the opposite case because it was inconsistent with their public position.

*Inconsistency in HMRC's position*

84. In particular, the Appellants maintain that HMRC's position in this case that ADRs only give rights in personam and not rights in rem is inconsistent with what is said in HMRC's manuals. For instance, the Capital Gains Tax manual says:

“for capital gains tax purposes, the holder of the depositary receipt has two separate chargeable assets, namely, a beneficial interest in the underlying shares and the depositary receipt, being the document evidencing title and comprising a number of rights as against the depositary....”

85. HMRC points out that this is its statement of opinion on English and not US law and the two are not necessarily the same. We have not been asked to consider the position as a matter of English law but our opinion is that whether a trust is created would depend on the terms of the Deposit Agreement. In any event, whatever HMRC states in its manuals is not necessarily an accurate statement of the law and, at least so far as this hearing is concerned, as it is not a judicial review, there is nothing to prevent HMRC adopting a position apparently inconsistent with its manuals. We make our findings uninfluenced by HMRC's published opinions.

86. We also find, based on the evidence of Mr Quinlan (who advised the Appellants on the transactions at issue in this appeal), that HMRC have taken the position in practice that there is no charge to stamp duty when a share is withdrawn from a depositary scheme. It is of course the Appellants' view that this is right because they consider the ADR holder already possesses the beneficial interest in the share withdrawn. They consider that only the £5 fixed duty on a transfer other than on sale (Finance Act 1999 Schedule 13 paragraph 16 discussed below in paragraph 162) would apply to such a transfer. Therefore, they say, it is inconsistent for HMRC to advance the opposite case here.

87. We do not accept this submission. Firstly, it appears to us that even if the transfer of the underlying share on its withdrawal from the depositary scheme did involve the transfer of full title, nevertheless it may not be a transfer *on sale*. This point is not beyond dispute as it was a term of the Deposit Agreement, which was a contract between third parties for consideration, that the investor could withdraw the

underlying shares. In any event, even if HMRC's position on the tax liability on such transfers was inconsistent with its position in this case, this cannot and does not influence the decision we reach. This is not a judicial review of HMRC. We make our findings in accordance with our, and not HMRC's, perception of the law.

5 *The Deposit Agreement*

88. In order to consider whether holders of HSBC ADRs have rights in rem in the underlying shares, we first consider the contract under which the ADR holders hold their ADRs and then the law which applies to that contract, and then reach our conclusion.

10 89. All parties were agreed that the rights of the ADR holders were governed by the Deposit Agreement (see paragraphs 7-10 above). This was a document which pre-  
dated the transactions in this case and affected all holders of HSBC ADRs and not just  
the former Household stockholders who became HSBC ADR holders as a result of the  
merger at issue in this case. The terms of that merger are therefore irrelevant to the  
15 question of the rights of the HSBC ADR holders and no one suggested otherwise.

90. The Deposit Agreement and therefore the ADRs were subject to the provisions of New York law. As stated, this is a question of fact for the Tribunal and it was one on which we had the benefit of expert opinion.

*New York Law*

20 91. Each side in this appeal appointed an expert witness. We heard expert evidence from Mr Robert A Rudnick. Mr Rudnick is a member of the Bar of the District of Columbia and of New York and obtained his law degree in 1972. He practises law and has for many years been the head of the global tax group with the firm of Shearman & Sterling LLP in the US: he specialises in advising on all aspects of US  
25 Federal income tax, particularly the taxation of financial institutions and financial products. He is an Adjunct Professor in the LLM programme at Georgetown University School of Law and has written a number of articles about the tax treatment of financial products. We accepted him as an expert in the area of New York law on the legal nature of an ADR.

30 92. We also heard expert evidence from Ms Roberta S Karmel, who is currently Professor of Law at Brooklyn Law School in New York and has held academic appointments at many other Universities. She has been a member of the bar in the State of New York since 1962 and in her career has specialised in corporate and securities law and financial regulation and practised law for 30 years in major law  
35 firms in New York City. She has written and contributed to books and many publications dealing with aspects of securities law in the US. She was a Commissioner of The Securities and Exchange Commission (SEC) 1977-1980 and a public director of the New York Stock Exchange Inc 1983-1989. We accepted her as an expert in the area of New York law on the legal nature of an ADR.

93. Mr Rudnick and Professor Karmel gave evidence on US law applicable to the ADRs sponsored by HSBC. To a large extent they were in agreement about the laws applicable to ADRs. They were agreed that under New York law holders of ADRs enjoyed substantially the economic benefits of being the owner of the underlying HSBC share but did not agree on the crucial issue of whether the holder of an ADR had a proprietary interest in the underlying HSBC share. They agreed that their main areas of disagreement, for the tribunal to determine, were:

1. On the insolvency of BNY, would or could the underlying HSBC ordinary shares represented by ADRs have fallen into BNY's receivership assets available to general creditors or would the ADR holders have received those HSBC ordinary shares?
2. Is an ADR a redeemable security, separate from the HSBC ordinary shares?
3. Does the fact that ADRs do not comprise a 'securities entitlement' to HSBC ordinary shares under the Uniform Commercial Code mean that the ADR holders do not have a property ownership right under US law in HSBC ordinary shares?
4. Does the ADR holders' right of disposition of the ADRs mean they have the right to direct the disposal of the underlying HSBC ordinary shares?

In reality, the answers to these questions depend on whether the holder of an ADR has a right in rem or in personam in respect of the underlying HSBC share and we move on to consider this single point.

94. Our findings of fact are as follows.

95. The purpose of an ADR is to represent the shares of non-US companies. The ADR gives the holder a security which can be traded on a US stock market; it provides a method by which foreign dividends are converted into US dollars, and allows the foreign shares to be quoted in multiples or fractions comparable to US securities. Technically, an ADS (American Depositary Security) is the security and the ADR (American Depositary Receipt) is the certificate which evidences it: but in the US the Securities and Exchange Commission now considers the distinction unnecessary and refers only to ADRs and we will do the same.

96. The HSBC scheme is a sponsored ADR scheme as indeed are all quoted ADR schemes. A sponsored scheme means that there is a deposit agreement between the bank (depository) and the issuer of the shares (in this case HSBC). That agreement in this case is the Deposit Agreement.

97. We were told, and on the basis of that evidence we find, that the HSBC scheme is fairly typical and the clauses in the Deposit Agreement standard for sponsored ADR programmes, but our findings of fact below are obviously limited to the HSBC scheme itself. We find ADR holders in the HSBC scheme have three main rights in respect of the underlying HSBC shares: redemption, voting and receipt of dividends,

and we consider these in turn below. First we consider BNY's retention of the underlying shares.

*Obligation to hold the deposited shares*

5 98. The scheme of the Deposit Agreement is that HSBC shares are deposited (by an investor or by HSBC) and in return ADRs are issued. It is also clearly implied in the Agreement but not explicitly stated that the deposited shares will be retained by BNY. This is implied because the scheme of the Deposit Agreement is that (a) it provides for the deposit and withdrawal of the HSBC shares by the investors; (b) it provides that the dividends will be passed to the investors and the investors' voting instructions  
10 actioned; and (c) it provides for a "custodian" to hold the deposited shares. The provision of a custodian might be considered entirely unnecessary if BNY were free to sell the shares as a beneficial owner but the clause itself merely says that BNY "may" appoint a custodian who on appointment would act as BNY's agent.

15 99. So we do not think these considerations resolve the question of beneficial ownership. As discussed below, as a matter of contractual agreement, BNY is obliged to pass the dividends to the ADR holders and (to some extent) allow the ADR holders to instruct it how to vote: it could not fulfil at least the second of these terms if it did not possess the shares. So although the underlying clear assumption of the Deposit Agreement is that BNY will hold the shares (and sometimes collateral in a pre-release  
20 situation), this may be to enable it to fulfil its contractual liabilities rather than because a trust is established.

100. Even the holding of collateral is expressed to be for the purpose of giving BNY security to enforce the obligation of the ADR holder in a pre-release situation to deliver to BNY the correct number of HSBC shares (clause 2.10). It is not expressed  
25 to be because BNY holds the fund on trust for the ADR holders: the clear purpose of the collateral is to ensure BNY receives the HSBC shares. This begs the question of whether BNY holds the HSBC shares in order to fulfil its contractual obligations to vote the shares in accordance with the ADR holders' instructions or because it was intended that it should hold the HSBC shares on trust for the ADR holders.

30 *Withdrawal*

101. An ADR holder was entitled at any time to convert its ADR into the underlying HSBC shares. This right is largely unfettered, but under the terms of the Deposit agreement BNY could refuse to redeem the ADR where the ADR holder is indebted to the bank (clause 2.06) or it would be in breach of the law for the bank to do so  
35 (clause 5.02). The terminology was disputed by the experts: in such a case would the ADR holder be "withdrawing" the HSBC share in which he already had a proprietary interest or merely redeeming the ADR for an HSBC share?

102. The terminology of the Deposit Agreement was "withdrawal of shares" and of course the ADR is a "receipt" so we would agree with the Appellants that the language suggests the concept of a deposit of an item of property for which the owner  
40 is given a receipt.

### *Dividends*

103. We find an ADR holder substantially enjoys the economic benefits of being a shareholder of the ordinary shares but its rights are not identical. An ADR holder is entitled to the cash dividends but minus the bank's administration fees. It is also  
5 entitled to non-cash dividends, but at the option of the bank, the bank can pay a cash equivalent to the ADR holder rather than the actual dividend. The bank has the right to pass on rights offers to the ADR holders or sell the rights and make the cash available instead: and if not lawful or "feasible" to do this it could allow the rights to lapse. It was entirely in the bank's discretion to decide whether or not it was lawful or  
10 feasible to utilise any rights offer.

104. In conclusion, the rights of an HSBC ADR holder to dividends were not quite equal to the rights of an HSBC shareholder.

### *Voting*

105. Unlike actual shareholders, ADR holders cannot vote in HSBC shareholder  
15 meetings on a show of hands: after all, BNY only has one vote on a show of hands. Clause 4.06 provides that the ADR holder can instruct the bank which way to vote on a poll. However, BNY is only obliged to endeavour to inform the ADR holder of a vote in time for him to give instructions, and only obliged to endeavour to carry out the instructions: it has no liability for failing to do either of these things. The bank is  
20 obliged *not* to vote other than on instructions.

106. We note and agree with Professor Karmel's view that these discrepancies between the rights of a holder of an ADR and the rights of a direct shareholder of underlying shares are likely to be viewed by a private investor as a minor and acceptable trade-off for the benefit of being able to trade the ADR on the US stock  
25 market: but such discrepancies are likely to be unacceptable to an institutional investor who is therefore going to prefer to hold the HSBC shares rather than ADRs. This accords with common sense and is in fact what appeared to happen in this case and is the reason why the flowback arrangement was put in place.

107. Our conclusion on the rights to dividends, voting and withdrawal is that these  
30 rights were all contractual as they were provided for in the Deposit Agreement. None of the rights imply that of necessity there is a trust: they work simply as contractual rights intended to mimic as closely as practicable real ownership. We go on to consider other relevant clauses and in particular the rights of the ADR holder if the Deposit Agreement was terminated.

### *Rights on termination of the deposit agreement*

108. Clause 6.02 of the Deposit Agreement provided that if BNY decided to terminate  
40 the agreement, ADR holders would have 90 days to withdraw their HSBC share from the scheme before it was terminated. After termination they would have another year to withdraw the underlying shares. If they did not do this, BNY could sell the underlying shares and hold the proceeds unsegregated with the ADR holders becoming general creditors of the company.

109. The Appellants' view of this clause is that by implication the HSBC shares are to be held segregated and the ADR holders are not general creditors up to the moment one year plus 90 days when the last part of this clause of the Deposit Agreement comes into force. HMRC put the alternative case that if the ADR holders truly held a  
5 proprietary interest in the underlying shares, the Deposit Agreement would have said so and clause 6.02 would not provide for the shares to become assets of BNY available to all its creditors. Our conclusion is that this clause is ambiguous on the question.

110. We move on to consider whether there is anything in the provisions of the law  
10 applying in the State of New York which determines whether the rights of an ADR holder are in rem or in personam.

#### *US tax law*

111. As we understand it, US tax law is federal law and applies in the State of New York. US tax law does not use the term "beneficial" owner. It is Mr Rudnick's view  
15 that the owner of an ADR is treated so far as US tax law is concerned as the owner of the underlying HSBC shares. He states that the Internal Revenue Service (not a court) has held that a holder of an ADR is the owner of the underlying share. He also cites a case *Compaq Computer Corp v Commissioner* 277 F.3d 778 (5<sup>th</sup> Cir. 2001) in which a US tax court decided that "an ADR is a trading unit issued by a trust, which  
20 represents ownership of stock in a foreign corporation that is deposited with the trust...".

112. Professor Karmel's view, on the other hand, is that as a matter of law it has not been decided for tax purposes that ADR holders have a proprietary interest in the underlying shares, but merely that they are liable to tax as if they held the underlying  
25 shares. We find this accords with the extract from the *Compaq* case which decided that an ADR "represents" ownership of the underlying share. We also agree with Professor Karmel that unless it is shown to this Tribunal (which it wasn't) that US tax law depends on proprietary interests for liability to tax, whether or not an ADR holder is taxed as a shareholder of the underlying share does not tell us whether or not the  
30 ADR holder has a proprietary interest in it. Indeed Mr Rudnick cites a Supreme Court case (*Corliss v Bowers* 281 US 376, 378 (1930)) where the court observed that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed – the actual benefit for which the tax is paid."

113. Our conclusion is that the answer to the question of whether an ADR holder has a  
35 proprietary interest in the underlying fund of shares and other collateral which backs the ADRs in issue is not to be found in US tax law.

#### *US Securities law*

114. Mr Rudnick's conclusion is that the holder of an ADR possesses all the economic and other rights in the underlying shares and that in US federal securities  
40 law he is the beneficial owner of the underlying shares.

115. Professor Karmel agrees that under federal securities law an ADR holder is deemed to be a beneficial owner, but points out that ‘beneficial owner’ may not have the same meaning as under UK common law. US federal securities law provides a person has beneficial ownership if “through any contract arrangement understanding relationship or otherwise” it “has or shares voting power” (as defined) or “investment power” (as defined). It also deems someone to have beneficial ownership if they have the right to acquire beneficial ownership.

116. We agree with Mr Swift that this definition means that more than one person could be the beneficial owner of the same property: for instance, under this definition both the actual owner and a person who holds an option to buy the shares are beneficial owners of the shares at the same time. Therefore, the meaning of beneficial ownership is clearly wider than actual ownership of a proprietary interest and wider than beneficial ownership as a matter of English common law. And this is not surprising: we agree with Mr Swift that the purpose of US securities law is regulation. A greater than 5% beneficial ownership must be reported to the state. In other words, it is designed to ensure notification of an actual or contingent ability to control a company: it was not designed merely to identify who has the actual beneficial (or proprietary) interest in a share at any one time.

117. US securities law is therefore of little help in determining the proprietary interests in the underlying shares and collateral held by BNY as a term of the Deposit Agreement.

#### *Uniform Commercial Code*

118. The Uniform Commercial Code (UCC) is part of the law of the State of New York. The UCC draws a distinction between a security and a securities entitlement. In summary, a securities entitlement is where the actual security is held by an intermediary with legal title. §8-102(17) of the UCC describes a security entitlement to be “the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5 [of Article 8].” An ADR is not a security entitlement as the comment says that Part 5 of Article 8:

“does not apply to an arrangement in which a security is issued representing an interest in underlying assets, as distinguished from arrangement in which the underlying assets are carried in a securities account. A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument or pool thereof, creates interests in that asset or pool which are sold to others. In many such cases, the interest so created will fall within the definition of ‘security’....Accordingly, an arrangement such as an ADR facility which creates freely transferable interests in underlying securities will be issuance of a security under Article 8 rather than establishment of a security entitlement to the underlying securities”

119. Both Professor Karmel and Mr Rudnick agreed that an ADR was a security and not a securities entitlement. They disagreed on what this meant. Mr Rudnick’s view

is that the reference to the “interest” in the underlying asset in the above quotation is a reference to a proprietary interest in the underlying asset. We cannot agree. The UCC is clearly saying that the ADR is a security in its own right whereas a securities entitlement is not. And while it does see the ADR holder as having an “interest” in the underlying share it is silent on whether or not that is a proprietary interest. We note that while §8-102 refers to “the rights and *property* interest...”, the comment (quoted in full in the previous paragraph) refers to “interest” and “representing an interest” suggesting “interest” was intended to be wider than “property interest”.

120. Professor Karmel’s view is that the UCC by implication means that the holder of an ADR does not have a property interest in the underlying fund held by the bank. This is because the UCC provides that any intermediary holding a security to which a investor has a securities entitlement does not have a property interest in the security: the clear implication of this is that the investor with a securities entitlement *does* hold the property interest in underlying security. And since the UCC makes a distinction between a security and a securities entitlement the clear impression is that the holder of a security such as an ADR does *not* have a property interest in the underlying securities (because otherwise the UCC would treat it as a securities entitlement rather than a security).

121. Mr Glick’s point is that there are interests which are not securities entitlements but nevertheless are proprietary interests and he cites the example of an ordinary trust of shares. We agree: but that is no answer to the point of why the UCC would draw a distinction between a security and a securities entitlement unless they were different. Professor Karmel’s comparison is to assets held by a company: shareholders of that company have an interest in the assets in the broadest sense but their interest is not a proprietary one. A comparison closer to the facts in this case which she makes is to a redeemable interest in a US mutual fund which does not give a proprietary interest in the underlying asset unless and until it is redeemed.

122. Our conclusion is that the UCC by making the distinction between securities and securities entitlements implies that ADRs, being securities in their own right, do not give the holders a right in rem in the underlying shares.

#### *Sale of shares in breach of deposit agreement*

123. Both experts originally agreed that if BNY sold the HSBC shares in breach of the Deposit Agreement then good title cannot be given to the purchaser unless that purchaser purchased for value and without notice and took possession of shares. This would suggest to us that both experts considered that the holder of the ADR had a proprietary interest in the underlying HSBC shares: if the rights of the ADR holder against BNY were merely contractual, BNY could sell to a third party with good title in breach of contract albeit liable for any breach of contract to the ADR holders. In her oral evidence, we find Professor Karmel somewhat retreated from this view and implied she had not been thinking of the rights of the ADR holder but the rights of the bank.

124. Neither expert cited authority for their view on this question. Our conclusion is that it was not clear to us as a matter of US law whether only a bona fide purchase for value without notice could safely buy the HSBC shares should BNY sell them in breach of the Deposit Agreement. The answer to this begs the question of whether the ADR holder has rights in rem.

*US Insolvency Law*

125. Mr Rudnick considers that the ADR relationship is like the normal method of holding shares in the US which he calls “street name” where uncertificated shares are held by a depositary which holds it for a custodian (a bank) which holds it for a broker who holds it for an individual investor. Only the investor has beneficial ownership rights in the share: even though at that time it is in uncertificated form, the investor has the right to demand the transfer of the share to him.

126. Mr Rudnick cites the case of *Richardson v Shaw* 209 US 365 (1908) in which shares were held in “street” name. The broker had the right to buy and sell the shares, and was only obliged to hand over the right quantity of identical (but not the same) shares when asked. The court’s decision was that on the broker’s insolvency, the shares held by him were held on trust for the investor.

127. However, we agree with Professor Karmel that because the UCC treats an ADR as a security and not a securities entitlement, it cannot be assumed that the same outcome would follow with an ADR as with *Richardson v Shaw* where the investor would now be seen as holding a securities entitlement.

128. As a matter of regulatory law, were BNY to become insolvent, the Federal Deposit Insurance Corporation (“FDIC”) would take over the bank as receiver. The FDIC had written an Interpretative Letter saying that an ADR is a contractual interest in foreign securities held by the depositary and it is therefore not insured by FDIC but nevertheless the FDIC would try to terminate the ADR facility in accordance with contract. Both experts therefore agreed that in 2003 the FDIC would have tried to find another bank to administer the ADR scheme or otherwise have terminated the scheme in accordance with the Deposit Agreement. As termination in accordance with the Deposit Agreement means giving the underlying HSBC shares to the ADR holders (unless, as mentioned above in paragraph 108, no request is made for 1 year plus 90 days) and *not* holding them for the benefit of general creditors, this means that the FDIC would treat the ADR holders as having proprietary rights.

129. The view of the FDIC, which is a regulatory body, is of course not of equivalent persuasive value as the view of a court of law. Further, the Interpretative Letter refers to it as a *contractual* interest in foreign shares, which is not consistent with the FDIC’s apparent view that the assets would not be available to the general creditors.

130. In 2010 (long after the events of this appeal) the Dodd-Frank legislation was passed in the US and §210 of it obliges the FIDC to wind up any insolvent bank subject to legally enforceable securities entitlements. Professor Karmel’s view is that as ADRs are not securities entitlements this indicates that the underlying shares and

collateral held by the issuer of ADRs would be available for its general creditors. However, we agree with the Appellants that as this post dates the facts of this case it is not relevant as it may have represented a change in the law.

5 131. Mr Rudnick's evidence is that the Depository's creditors would have no rights to the shares in the scheme because the Depository had no beneficial interest in them. His view is that the only beneficial interest it has in the fund is the right to be paid its expenses for carrying out its duties. He sees the bank as a custodian with merely the bare legal title necessary for it to perform its obligations. His view is that although  
10 there is no legal precedent on what would happen on an insolvency of BNY or any other depository, nor a categorical pronouncement by the FDIC, on the balance of what authority there is, the FDIC would not treat the underlying shares as general assets of the insolvent bank.

15 132. Again, our conclusion on this evidence is that it is not clear what would have been the legal position on the insolvency of the ADR issuer at the time these HSBC ADRs were issued.

*Obligation to segregate:*

20 133. As part of the question of whether the bank holds the shares on trust for the ADR holder such that the ADR holder has a proprietary interest in the HSBC shares, the experts addressed the question of whether the bank was obliged as a matter of law to hold the shares segregated from its (other) assets.

25 134. Mr Rudnick's view is that the bank was custodian if not a trustee of the assets so like any custodian (or trustee) it must keep the assets segregated. He was also of the opinion that the regulators would have required segregation. Professor Karmel did not agree and her analysis of the various regulations cited by Mr Rudnick was that they did not apply to ADRs. Nevertheless, she was of the view that as a matter of practice she would have expected that BNY (or BNY Nominees) would hold the  
30 underlying shares and collateral segregated from other holdings. However, she did not agree that BNY was obliged to do this nor that, if it was the case that they were held segregated, that would give the ADR holders proprietary rights in the shares and collateral. We found Mr Rudnick's view circular in that he appeared to consider that the assets must be held separately as the bank was a custodian, but elsewhere seemed to consider that the bank was a custodian because the assets must be held segregated.

35 135. We find that the Deposit Agreement does not expressly require BNY to hold the assets in a segregated account: nevertheless as we have commented in paragraph 98, the Deposit Agreement allows BNY to appoint a custodian. This does not amount to a clear obligation to hold the shares segregated. We think that if it had been seen by the parties as important, it would have been an express provision.

40 136. In conclusion we are satisfied that there were no legislative or regulatory provisions which required segregation: whether general law required segregation because the assets were trust assets begs the question of whether the shares and

collateral were held in trust for the ADR holders and we reach our conclusion on this as set out below.

*Which expert's evidence do we rely on?*

5 137. Both experts were clearly very expert in the area on which they gave evidence but nevertheless in so far as their evidence was not consistent we have to choose between them. We found Mr Rudnick's view to be that of a practical lawyer and a little broad brush in approach. (An example of his broad brush approach was to say in answer to a question that legal title to the shares was held by the London branch of BNY: the true position was that it was held by BNY Nominees).

10 138. We consider his evidence reflected a long held assumption of many people dealing with ADRs, based on the practical realities of holding an ADR that it is just the same as holding the underlying share. In particular, his witness statement asserted what it was intended to prove which was that the Depository (BNY) has no proprietary interest in the underlying shares. His first report does not mention the  
15 difference between securities and securities entitlement but on the contrary refers to cases where the holder has a securities entitlement and is therefore assuming that the same rules would apply to a holder of a security, which is far from clear to us.

139. Professor Karmel's view (in summary) was that the true legal position in New York law of the holder of an ADR was unresolved in the courts and that in the  
20 extremely unlikely event of the insolvency of BNY the only thing that she could confidently predict was that there would be a lot of litigation over whether the underlying shares and collateral were owned by the ADR holders or available to BNY's general creditors. Nevertheless, her view was that the right answer to this question would be that the holder of an ADR had no proprietary interest in the  
25 underlying shares and collateral. We considered her analysis to be more in depth and we were not persuaded that Mr Rudnick's confidence that ADR holders had proprietary interests in the underlying shares was justified.

*Conclusion*

30 140. None of the matters referred to above in our opinion conclusively resolve the question of whether ADR holders have proprietary interests in the deposited shares.

141. ADR holders have contractual rights to dividends and to vote which mimic if imperfectly the rights of a holder of the underlying share. But these are rights arising under contract and are not necessarily the same rights as the rights they would hold as beneficiaries of a trust of shares. The fact the ADR holders have these rights does  
35 not require a trust to be implied: the rights work perfectly well simply as a matter of contract law.

142. Similarly, ADR holders have a contractual right to redeem or withdraw the shares. Again this works as a matter of contract law and does not require a trust to be implied. We read little into the use of the word "withdraw" because we don't think its  
40 use necessarily implies a proprietary interest in the thing withdrawn (eg money is

withdrawn from a bank account but that does not mean before that withdrawal the account holder has a proprietary interest in the bank's funds).

143.No express trust is created on the face of the Deposit Agreement, and we do not see that it follows that one should be implied. We say this taking into account the  
5 underlying assumption in the Deposit Agreement that BNY will actually retain the HSBC shares deposited with it and not sell them: as we have said above the explanation for this underlying assumption may simply be that BNY has to retain the shares in order to fulfil its contractual liabilities as regards voting. If the parties intended to create a trust, why was this not on the face of what is a very long  
10 document?

144.The purpose of the Deposit Agreement, in our opinion, reflecting what Professor Karmel said in her report, is to enable investors to hold securities which can be traded on the US stockmarket and which represent foreign securities. To achieve this there is no need for the investors to have a beneficial interest in the underlying foreign  
15 security: all they need is a tradeable US security such as an ADR.

145.Mr Glick's view, on the contrary, was that it was fanciful to suggest BNY could have a beneficial interest in the HSBC shares as, he says, it did not pay for any such thing. We cannot agree. Under the tri-partite Deposit Agreement BNY undertook very considerable obligations when issuing ADRs: most significantly it was liable to  
20 redeem ADRs for HSBC shares. So assuming the Deposit Agreement was merely a matter of contract law, the consideration for the receipt of the HSBC shares would have been its issue of the ADRs (as well as the fees it charged). Mr Glick is wrong to say that such an arrangement could not work merely as a matter of contract law and that a trust must be implied.

25 146.It is true that the rights of the ADR holders under the Deposit Agreement are not only very similar to those of someone with a proprietary interest, they are intended to mimic the rights of someone with a proprietary interest. But they are rights given by a contract. This does not make them a proprietary interest.

147.Our conclusion is that while it may be the case that many commentators and  
30 professionals have assumed that because an ADR is meant to represent an ownership interest in the underlying shares and collateral held by the bank that it necessarily does create a proprietary interest for the investor in the underlying shares, there is nothing in the contractual documents that apply to the relationship between the investor and bank that expressly creates a trust and nothing in the relationship that  
35 would necessitate a trust being implied. There is nothing, either, in the laws which apply in the US State of New York (of which we were informed) that deems the relationship to be one of trustee and beneficiary. On the contrary the UCC, by considering an ADR to be a security itself and not a securities entitlement, implies that an ADR does not give the holder of it a proprietary right in the underlying stock.

40 148.Overall our conclusion is that we are not satisfied as a matter of fact that under the law of the State of New York the holder of an HSBC ADR has a beneficial

interest in the underlying fund of HSBC shares held by BNY Nominees as custodian for BNY.

### *Summary*

149. That concludes the first part of this decision notice which deals with our findings  
5 of fact. In particular, we reject the Appellants' case that subsequent to the issue of the  
shares to CTCNY the only transfer in respect of the HSBC shares was the transfer of  
bare legal title with the former Household stockholders retaining their proprietary  
interest in the shares. We reject their case that the former Household stockholders  
retained the beneficial interest they acquired on the issue of the shares to CTCNY. We  
10 make this finding for two reasons. Firstly, on any scenario, as explained in paragraph  
81, beneficial title in those transferred shares moved at the same time as the legal title  
(although not to BNY Nominees) and, secondly, that in any event ADR holders do not  
have rights in rem to the deposited shares.

150. We move on to consider whether the SDRT charged on the transfer to BNY  
15 Nominees was lawful.

### **UK law**

151. Stamp duty reserve tax ("SDRT") was imposed by s 93 FA 86 which provided as  
follows:

20 "(1) Subject to subsection (7) below and section 95 below, there shall  
be a charge to stamp duty reserve tax under this section where in  
pursuance of an arrangement –

(a) a person falling within subsection (2) below has issued or is to  
issue a depositary receipt for chargeable securities, and

25 (b) chargeable securities of the same kind and amount are transferred  
or issued to the person mentioned in paragraph (a) above or a person  
falling within subsection (3) below, or are appropriated by the person  
mentioned in paragraph (a) above or a person falling within subsection  
(3) below towards the eventual satisfaction of the entitlement of the  
receipt's holder to receive chargeable securities.

30 (2) A person falls within this subsection if his business is or includes  
issuing depositary receipts for chargeable securities.

(3) A person falls within this subsection if his business is or includes  
holding chargeable securities as nominee or agent for the person who  
has issued or is to issue the depositary receipt.

35 (4) Subject to subsections (6) and (7) below, tax under this section  
shall be charged at the rate of 1.5% per cent of the following –

(a) in a case where the securities are issued, their price when issued;

(b) in a case where the securities are transferred for consideration in  
money or money's worth, the amount of value of the consideration;

40 (c) in any other case, the value of the securities.

.....”

5 152. The effect of this provision is that 1.5% ad valorem duty is chargeable only when both a depositary receipt for chargeable securities is (or is to be) issued and those chargeable securities are transferred or issued to the depositary or its agent or nominee.

153. Section 94 FA 86 gave the definition of “depositary receipt for chargeable securities” as:

“(1) ....an instrument acknowledging –

10 (a) that a person holds chargeable securities or evidence of the right to receive them, and

(b) that another person is entitled to rights, whether expressed as units or otherwise, in or in relation to chargeable securities of the same kind, including the right to receive such securities (or evidence of the right to receive them) from the person mentioned in paragraph (a) above .....

15 154. It was common ground between the parties that the HSBC shares issued in the events giving rise to this appeal were chargeable securities. It is also common ground that the HSBC ADRs issued in the events giving rise to this appeal were depositary receipts for chargeable securities.

20 155. It was agreed by the parties and we find that as a matter of English law, and in particular s 93 FA 86, a charge to SDRT at 1.5% arose on BNY (which HSBC agreed to pay) at the point that CTCNY transferred the HSBC shares to BNY Nominees. This is because the preconditions to liability in s 93 were at that point fulfilled. In particular, BNY (a person whose business included issuing ADRs) either already had issued (in the case of the flowback arrangements) or would immediately issue (in the case of elections made outside the flowback periods) ADRs for HSBC shares (s 25 93(1)(a)) and HSBC shares were transferred to BNY Nominees Ltd (a person holding the shares as nominee for BNY – see s 93(3)).

156. The person liable to pay the SDRT is designated in s 93(8) & (9) FA 86 as follows:

30 “(8) Where tax is charged under the preceding provisions of this section, the person liable for the tax shall (subject to subsection (9) below) be the person who has issued or is to issue the depositary receipt.

35 (9) Where tax is charged under the preceding provisions of this section in a case where securities are transferred, and at the time of the transfer the person who has issued or is to issue depositary receipt is not resident in the United Kingdom and has no branch or agency in the United Kingdom, the person liable for the tax shall be the person to whom the securities are transferred.”

40 157. It was accepted that BNY was the person liable to pay the tax under s93(8) and that s93(9) did not override this liability as BNY had a branch or agency in the UK.

158.Regulation 4 of the Stamp Duty Reserve Tax Regulations 1986 No 1711 provided:

- 5                                   “(1) Subject to paragraph (3), an accountable person, except where different arrangements are authorised in writing by the Board, shall on or before the accountable date –
- (a) give notice of each charge to tax to the Board, and
- (b) pay the tax due.”

159.It was also an agreed fact that by an exchange of correspondence between HSBC and HMRC in April 2003, “different arrangements” had been authorised in writing by HMRC and those arrangements were that HSBC would take responsibility to pay the SDRT to which BNY was liable arising out of the transactions described in this decision notice.

160.Both BNY and HSBC were parties to this appeal and their right to be so was not challenged. BNY was the taxpayer and HSBC had assumed its liability to pay the tax. Both have a direct interest in whether the tax was lawfully due.

*What if the transfer had only been of bare legal title?*

161.As mentioned above, it was part of the Appellants’ case that the former Household stockholders retained the beneficial interest in the HSBC shares from the moment they were issued to CTCNY on trust for them until and after the ADRs were issued to them (assuming they elected for ADRs). We have rejected that case on the facts. But what if it had been right: would SDRT have been payable on the transfer from CTCNY to BNY Nominees?

162.The Appellants referred us to Finance Act 1999 (“FA 99”) Schedule 13 paragraph 16 which provides:

- 25                                   “Stamp duty of £5 is chargeable on a transfer of property otherwise than on sale”

163.If we understood them, the Appellants’ point was that the transfer from CTCNY to BNY Nominees would attract a fixed duty of £5 as (in their view) it was a mere transfer of legal title and not a transfer on sale (BNY did not pay CTCNY for the shares). Therefore, say the Appellants, SDRT under s 93 FA 86 should not be charged as well.

164.We are unable to agree for two reasons. Firstly, there is nothing on the face of the legislation to suggest that s 93 FA 86 and paragraph 16 of Schedule 13 of FA 99 are mutually exclusive. On the contrary, s 93 appears to anticipate transfers not for money or money’s worth as the valuation provisions in sub-section (4) provide for both the position of a transfer for money or money’s worth and a transfer “in any other case”. Secondly, we cannot agree that the transfer was “otherwise than on sale”. Although by itself the transfer from CTCNY to BNY Nominees was without consideration, it was nevertheless a contractual part of an overall transaction (the merger) which was very much for consideration. In order to fulfil its contract with the

former Household stockholders and provide those that wished it with ADRs, and as part of its agreement with BNY to pre-release such ADRs, HSBC was bound to cause CTCNY to make the transfer to BNY Nominees and CTCNY was bound to make the transfer .

5 165. In conclusion, even if the Appellants had made out their case that after the initial issue of HSBC shares, the only subsequent transfer was a transfer of mere legal title, we do not agree that the SDRT was not chargeable under FA 86. At first glance this may seem an odd conclusion to reach but we believe it is consistent with the statutory  
10 intention to charge SDRT at 1.5% on securities entering a depositary system in order to frank future transfers of the related ADR which will be free of stamp duty. It would be odd if the SDRT charge was defeated if an ADR gave a holder a beneficial interest in the underlying shares when it seems even HMRC had previously assumed this was the case with all ADRs.

15 166. The main issue in the case, of course, was whether that SDRT charge was lawful under European law and we move on to consider this.

### **European Law**

167. The provisions of FA 86 are not the end of the story. European law is relevant to this appeal as Parliament has so provided in the European Communities Act 1972. This Tribunal is obliged to give effect to the Treaties of the EU as s 2 of that Act  
20 provides that we must; and s 3 of that Act provides that

25 “for the purpose of all legal proceedings any question as to the meaning or effect of any of the Treaties, or as to the validity, meaning or effect of any EU instrument, shall be treated as a question of law... for determination as such in accordance with the principles laid down by an any relevant decision of the European Court.”

The Court of Justice of the European Union (“CJEU”) has propounded the doctrine of direct effect and therefore, to the extent they are directly effective, Directives as well as articles of the Treaty are given effect to in this Tribunal.

30 168. The claim by the two Appellants for repayment of the SDRT was on the grounds that the SDRT charge contravened the provisions of Articles 10 and 11 of EC Directive 69/335/EEC (as amended and known as the Capital Duties Directive) and/or the provisions of Article 56 of the EU Treaty. We consider the Directive first and then the Treaty.

### **Capital Duties Directive**

35 169. The Capital Duties Directive provided as follows in Article 10:

“Apart from capital duty, Member States shall not charge, with regard to companies, firms, associations or legal persons operating for profit any taxes whatsoever:

(a) in respect of the transactions referred to in Article 4...”

The transactions referred to in Article 4 included, at Article 4(1)(c):

“an increase in the capital of a capital company by contribution of assets of any kind.”

170.A further prohibition was contained in Article 11:

5 “Member States shall not subject to any form of taxation whatsoever, (a) the creation, issue, admission to quotation on a stock exchange, making available on the market or dealing in stocks, shares or other securities of the same type, or of the certificates representing such securities...by whomsoever issued.”

10 171.Article 12, however, provided as follows:

“1. Notwithstanding Articles 10 and 11, Member States may charge:  
(a) duties on the transfer of securities, whether charged at a flat rate or not.”

15 The Appellants considered that the SDRT charge in this appeal was unlawful under either or both Articles 10 or 11; HMRC considered it was lawful under Article 12.

### **Tax charge in breach of Article 11 CDD?**

172.It is the Appellants’ case that the SDRT charge in this case was unlawful under Article 11 because either or both (a) it was a tax on the *issue* of the HSBC shares or (b) it was a tax on the *issue* of the ADRs, as they were certificates representing such shares.

*Was it a tax on the issue of the ADRs?*

173.HMRC’s case is that the tax charge did not arise on the issue of the ADRs. Its case was that it was merely a precondition of the tax liability that ADRs had been or were to be issued: the chargeable event was the transfer of the HSBC shares to BNY Nominees. To recap, s 93 FA 96 provides (the full provision is set out above):

“...there shall be a charge to stamp duty reserve tax ...where in pursuance of an arrangement –

(a) a person ... has issued or is to issue a depositary receipt for chargeable securities, and  
30 (b) chargeable securities of the same kind and amount are transferred or issued .....

174.We cannot agree with HMRC. The chargeable event, the transfer of the shares, merely dictated the *time* when the liability to pay the tax arose. For there to be tax *liability* there had to be both an actual issue of ADRs, whether at the time or in the future, in exchange for a transfer or issue of shares.

175.Yet Article 11 prohibits tax on “the creation, issue, ....of the certificates representing such securities...by whomsoever issued.” HMRC’s point is that the tax

charge was on the transfer of the HSBC shares from CTCNY to BNY Nominees, and not on the actual issue of the ADRs. Yet that charge could only arise under s 93 because there was an actual or prospective issue of ADRs. We do not think it makes a difference that the tax did not necessarily arise at the time of the issue of the ADRs:  
5 we think it was a tax on the “issue” of the ADRs as there had to be an issue of ADRs, whether current, historic or future, in order for the tax liability to arise.

176. However, although we resolve that issue against HMRC, this is not sufficient to resolve this case. One reason for this is that for the tax charge to arise there had to be both the issue of the ADR and the transfer of the underlying share to the issuer or its  
10 nominee: Article 12 of the Capital Duties Directive permits a tax on the transfer of shares while Article 11 prohibits a tax on the issue. Which article predominates where the tax charge is imposed only where there is an issue of ADRs *linked* to a transfer of shares as in this scenario? This question only matters if our conclusion is that the transfer from CTCNY to BNY Nominees was within Article 12: if we agree  
15 with the Appellants that it was, as with the issue of the ADRs, within either or both Articles 10 and 11, then the conclusion is (subject to the issue of territoriality) that the SDRT charge was levied unlawfully.

177. Far more importantly, the illegality of a tax on issue of an ADR only matters on the facts of this case if the Capital Duties Directive has any application in the situation  
20 of an issue of ADRs by a US bank: we deal with this point below in paragraphs 305-311. In the meantime we consider the Appellants’ case that the SDRT was not only a tax on the issue of the ADRs but also a tax on the issue of the HSBC shares.

*Was it a tax on the issue of the HSBC shares?*

178. HMRC’s case is that, although “issue” in Article 11 includes the first acquisition  
25 of the shares, the first acquisition of these HSBC shares was by CTCNY. The SDRT was charged on the *transfer* of the shares by CTCNY to BNY Nominees. It is because the shares were *issued* to CTCNY (as trustee for the Household stockholders) and then *transferred* to BNY Nominees that the tax charge arises on the transfer and not on the issue of the shares. The issue was complete no later than 31 March 2003  
30 when the allotment of HSBC ordinary shares to CTCNY became complete.

179. The Appellants accept that technically the legal ownership of the shares was transferred and not issued to BNY Nominees but considers that “issue” must be construed purposively, as it was by the CJEU in *EC Commission v Belgium* [2004] I-7215 (C-415/02) (“*Belgium*”), so that where what HMRC is doing is “in reality to  
35 taxing the very issue of that security as it forms an integral part of an overall transaction with regard to the raising of capital” it is unlawful under Article 11. It is also the Appellants’ case that the transfer was a transfer under UK law but that does not make it a transfer under Capital Duties Directive.

*The scope of Article 11*

40 180. In brief, the dispute on Article 11 and the transfer of the HSBC shares is whether the meaning of “issue” in Article 11 is restricted to the transfer of shares integral to

their issue to the subscriber or, as in this case, a nominee for the subscriber (HMRC's view) or whether it includes a subsequent transfer of shares which is integral to the capital raising transaction if not integral to the issue of the shares (the Appellants' view).

5 181. Both parties were agreed that the effect of the CJEU decisions *Belgium* and  
*HSBC Holdings plc and another v HMRC* (“*Vidacos*”) C-569/07 [2010] STC 58 was  
that the meaning of “issue” for Article 11 does include the first acquisition of those  
shares consequent on their issue. The dispute between them was about the ratio of  
10 these cases: was the first acquisition of shares part of the “issue” because it was  
integral to the act of issuing shares, or because it was integral to the capital raising  
transaction?

182. To answer this we have to consider the CJEU decisions in those two cases.

15 183. Belgian domestic legislation charged stamp duty on the allotment of shares to  
subscribers following a public offer and also on the physical delivery to subscribers of  
bearer shares following a public offer. The Belgian Government's case was the  
allotment or physical delivery involved a transfer and under Article 12 transfers could  
be taxed.

184. The Advocate General in his Opinion said that:

20 “[14] ...capital does not move in a vacuum and, therefore, raising it -  
whether with a view to setting up a company, increasing capital or  
issuing a debenture loan - cannot take place without the allotment or  
delivery of the new securities to the subscribers. From an economic  
point of view, therefore, taxing these operations is equivalent to taxing  
25 their issue and thus, essentially, to taxing the raising of the capital  
which they represent.

....

30 [16] That also appears to be confirmed indirectly by the case law of the  
Court, which has expressed a clear view in favour of the need for a  
broad interpretation of the provisions in question to suit the aims of the  
Directive.”

The CJEU said:

35 “[32] While it is true, as the Belgian Government submits, that that  
provision does not expressly mention the first acquisition of stocks,  
shares or other securities of the same type, the fact remains, as the  
Advocate General pointed out in paragraph 14 of his Opinion, that to  
permit the levying of tax or duty on the initial acquisition of a newly  
issued security amounts in reality to taxing the very issue of that  
security as it forms an integral part of an overall transaction with  
regard to the raising of capital. The issue of securities is not an end in  
40 itself, and has no point until those securities find investors.

[33] For Article 11(a) of Directive 69/335 to have practical effect,  
therefore, ‘issue’ for the purposes of that provision must include the

first acquisition of securities immediately consequent upon their issue.”

The CJEU here clearly gives Article 11 of the Capital Duties Directive a purposive construction as indeed we would expect it to do.

5 185. What did the CJEU see as the purpose of Article 11? It indicated that the issue of securities has no point until the securities find investors and therefore, by implication, any transfer up to and including the transfer of the securities to the first investors is integral to the issue and exempt from tax under Article 11. It also suggests, because it referred approvingly to paragraph 14 of the Advocate General’s Opinion, that it  
10 concurred with his view that tax on the first transfer was a tax on issue not only because the first transfer is integral to the issue, but also because it was “taxing the raising of the capital which [the shares] represent.”

15 186. HMRC’s point is that the HSBC shares found investors when they were issued to CTCNY which was nothing more than a nominee (or trustee) for the real investors, the former Household stockholders. This is because, as mentioned in paragraph 19 above, CTCNY held the shares on trust (expressed to be a bare trust) for the former Household stockholders.

20 187. The Appellants’ point, though, is that this was but the first step in a preordained series of transactions under which the investors, the former Household stockholders, would, in return for their investment be given, at their election HSBC shares or HSBC ADRs. Does Article 11 apply to exempt the subsequent step, the transfer from CTCNY to BNY Nominees, in this series of transactions?

*Economic reality over technical form*

25 188. The issue was considered again by the CJEU in the *Vidacos* case. The facts of that case were that HSBC wished to acquire a French company called Credit Commercial de France (CCF) and offered the CCF shareholders a share for share exchange. To make the offer attractive to French shareholders it was thought necessary to offer them securities which could be traded on the Paris stock market. HSBC therefore opened an account with Sicovam, the French settlement system for  
30 shares traded on the Paris Stock Exchange. The new HSBC shares were actually issued to Sicovam’s nominee, Vidacos Nominees Ltd. That company was the second appellant in the case.

35 189. HMRC considered that 1.5% SDRT was due on the shares issued by HSBC to Vidacos. Vidacos was the taxpayer (as was BNY in this case) but HSBC had agreed to meet the tax liability (as also happened in this case). The two appellants challenged the lawfulness of the SDRT charge and the case was referred to the CJEU.

40 190. Much of the case centred on an argument by HMRC that the SDRT charge was in reality a charge on future transfers of the shares within the clearance system operated by Sicovam, because, unlike transfers of shares, transfers within the clearance system would not be subject to stamp duty. This was referred to as the season ticket

argument. It was rejected by the CJEU and HMRC of course do not rely on it in this case.

191. The reasoning for the CJEU's decision that the SDRT charge was unlawful under Article 11 was as follows:

5                    “[31] In the main proceedings, the chargeable event giving rise to SDRT consists in the implementation of a specific transaction concerning the acquisition of securities newly issued on the occasion of a public offer. In that respect, as stated by the Advocate General in point 23 of his Opinion, the HSBC shares transferred into the clearance service to be exchanged for CCF shares constituted new shares, corresponding to an increase in capital.

10                    [32] It should be noted that to permit the levying of tax or duty on the initial acquisition of a newly issued security amounts in reality to taxing the very issue of that security as it forms an integral part of an overall transaction with regard to the raising of capital. The issue of securities is not an end in itself, and has no point until those securities find investors (*EC Commission v Belgium*).

15                    [33] For art 11(a) of the directive to have practical effect, therefore, ‘issue’ for the purposes of that provision, must include the first acquisition of securities immediately consequent upon their issue (*Commission v Belgium*).

20                    [34-36] ....

25                    [37] In the light of those considerations, it must be held that, to the extent that a tax such as SDRT is levied on new securities following an increase in capital, such a tax constitutes taxation for the purposes of Article 11(a) of the directive which is prohibited by that provision.”

192. Paragraphs 34-36 dealt with the CJEU's rejection of the season ticket argument and are set out in full below in paragraph 262. The two closely-linked reasons given by the CJEU for finding that the SDRT was unlawful were, as set out above, identical to the reasons given in *Belgium*.

193. As with the *Belgium* case, the CJEU said, in paraphrase, that “issue” included any transfer to the first investor. But the CJEU also said that taxing the acquisition of the newly issued security amounted to taxing the issue of the security “as it forms an integral part of an overall transaction with regard to the raising of capital.”

35    *The first investor*

194. HMRC do not agree that the reference to “an integral part of an overall transaction with regard of the raising of capital” in paragraph [32] adds anything to the reference to the “first acquisition of securities immediately consequent upon their issue” in paragraph [33]. We refer to this as the “first investor” point although this phrase was not used by the CJEU and is not one the parties would necessarily adopt. Our summary of HMRC's view is that they only consider something to be integral to the first acquisition of securities consequent upon their issue if it is integral to the issue of the shares to the first investor. However, we cannot agree. Not only does the

CJEU expressly refer to something that is integral to a capital raising transaction, it makes sense for that to be the purposive construction of Article 11. Why would Article 11 prohibit the tax on the issue of shares if it were not to prohibit the taxation on raising of capital? This is also inherent in the reference to the investor: the securities have to find investors because it is a two way process. The investors receive securities in return for their contribution of capital. A tax on any part of the process of receiving the securities in return for their contribution of capital is a tax on the raising of capital.

195. Our opinion is therefore that as a matter of European law, not only would the issue of the shares to CTCNY be exempt from tax under Article 11, but so would any subsequent transfer which formed an integral part of the overall transaction to raise capital for HSBC and which formed an integral part of the process of giving to the investors the securities in return for their contribution of capital.

196. But the parties do not agree when that point was reached. Was CTCNY the first investor so that the process of raising capital was complete when HSBC issued the shares to CTCNY? We do not think so. HSBC was contractually bound to give the former Household stockholders, at their election, legal title to HSBC shares or HSBC ADRs. The issue of the HSBC shares to CTCNY was merely an intermediate step in this process.

197. Alternatively could it be said that the former Household stockholders were the first investors and the process of raising capital complete when HSBC issued the shares to CTCNY on trust for them? We think that the former Household stockholders were the first investors in the sense that it was their acquisition of securities consequent upon the issue of HSBC shares which matters for the purposes of the Capital Duties Directive as explained by the CJEU in *Belgium* and *Vidacos*. However, as stated above, HSBC was contractually bound to give the former Household stockholders, at their election, legal title to HSBC shares or HSBC ADRs and their investment was not complete until they received what they were entitled to receive. We again reach the conclusion that the issue of the HSBC shares to CTCNY was therefore merely an intermediate step in this process.

198. But if the former Household stockholders are the ‘first investors’ (as indeed they must be as they are the persons who contributed the capital in exchange for new securities) then BNY must be a second or subsequent investor so that, on our finding that BNY was beneficially entitled to the HSBC shares deposited with BNY Nominees Limited (see paragraph 148 above), the transfer from CTCNY to BNY Nominees could not be the “first acquisition of securities immediately consequent upon their issue”.

199. In our view, though, that is answering the wrong question. The question is not in fact, ‘who is the first investor’ but ‘what forms an integral part of an overall transaction with regard to the raising of capital’. It does not matter in our view that BNY could be seen as a subsequent investor, but whether its acquisition of the HSBC shares was an integral part of an overall transaction by which HSBC raised capital.

200. But what is an integral part of the process of raising capital and was the transfer from CTCNY to BNY Nominees such an integral part?

*Was the transfer by CTCNY to BNY Nominees an integral part of an overall transaction with regard to the raising of capital?*

5 201. HMRC, citing English law and in particular *National Westminster Bank plc and another v Inland Revenue Commissioners* [1994] STC 580 per Lord Templeman at pp 584B-C and J, 588A-B and per Lord Lloyd at p 601B-C, point out that the issue of shares is complete when the name of the shareholder is entered into the company's register of members. This is irrelevant: the question is the meaning of "issue" in the  
10 Capital Duties Directive and not as a matter of English company law, and what the CJEU meant by "an integral part of an overall transaction with regard to the raising of capital".

202. One way of interpreting the CJEU decision in *Belgium and Vidacos* is that the transfer of the shares to the first investor was an integral part of the issue of the shares  
15 as it was essential: the shares could not be issued unless they were actually transferred to the investor. As we have said above this is too narrow: the question is whether it was an integral part of an overall transaction to raise capital. But does this require the part to be an essential element of the raising of capital? HMRC's case is that it was HSBC's choice to enter into the flowback arrangements and in particular to  
20 use CTCNY as exchange agent: it was not an essential element of the raising of capital as it was entirely HSBC's choice.

203. We do not think, however, the CJEU meant by the use of the word "integral" that the exemption in Article 11 should only apply to parts of the transaction by which capital was raised which were not optional. The object of that part of the Directive  
25 was to prevent taxation on the raising of capital. So in our view, any element of the transaction by which capital *actually* was raised is an integral part of it. It does not matter that an element was not essential in that the transactions could have been (but were not) structured differently. We should look at what actually happened and not what could have happened.

30 204. We also consider that the contractual arrangements must be considered in order to determine whether something was integral to the raising of capital. We do not see how whether a transfer is integral to a transaction can be objectively assessed unless the contractual arrangements are considered because that will indicate whether the transaction in question was actually part of the capital raising or not. HMRC do not  
35 appear to agree and cite (at least in respect of Article 10) the CJEU decision in *Codan*. For reasons we give in respect of Article 10 in paragraph 235-247 below, we do not think that the CJEU decision in *Codan* means that the contractual arrangements are irrelevant when assessing whether a step in a transaction is integral to it.

*When did the raising of capital complete?*

40 205. It is part of HMRC's case that in exchange for their shares, former Household stockholders received (a) HSBC shares and (b) a right to elect to exchange them for

5 ADRs and that therefore the capital raising was completed at the time of the merger as at that point HSBC had received the assets and liabilities of Household and issued the HSBC shares in consideration. Therefore, runs their argument, the transfer of shares from CTCNY to BNY Nominees was not integral to the capital raising because it took place after it.

10 206. We reject this. Capital raising involves both receiving the new capital and giving consideration for it in the form of new securities. By no later than 31 March 2003 HSBC had received the capital that it had raised: it owned, via H2 the assets and liabilities of Household. However, the process by which it had agreed to pay for  
15 Household was incomplete. It had agreed to give the former Household stockholders (at their election) HSBC shares or HSBC ADRs. This consideration was not provided merely by issuing HSBC shares to CTCNY (albeit on trust for the former Household stockholders). This did not give the former Household stockholders the securities they were promised: they held neither the legal title to the HSBC shares (if they wanted it) nor the ADRs (if they preferred ADRs). At the point of the merger, the former Household stockholders had yet to make their election (or refrain from making an election) for HSBC shares or HSBC ADRs.

20 207. If and when they made their election for ADRs, the ADRs were immediately issued. At this point the former Household stockholders who elected for ADRs had the securities that they were promised in return for their contribution of capital. But that did not complete the process of raising capital because it was a term of the Exchange Agency Agreement, Agency Agreement and Deposit Agreement that the HSBC shares must be deposited with BNY Nominees in order for BNY to issue the ADRs.

25 208. If the ADRs were not pre-released (and some were not – see paragraph 32), the transfer of the HSBC shares took place at the same time as the ADRs were issued. At this point (in respect of those ADRs) the process was complete: but the process included the transfer of the shares from CTCNY to BNY Nominees.

30 209. If the ADRs were pre-released, the transfer of the HSBC shares to BNY Nominees was delayed by up to 20 days. Nevertheless, such a transfer was bound to take place in that under the Exchange Agency Agreement and Agency Agreement, CTCNY was bound to make the transfer, and HSBC bound to ensure that it did so.

35 210. In the case of the pre-released ADRs, we find that the process of capital raising was therefore not complete until not only were the ADRs actually issued, but the terms on which BNY agreed to issue them had been fulfilled and in particular until the necessary HSBC shares had been transferred to BNY Nominees. Therefore, we find the process of raising capital in this case was not complete until CTCNY had made the transfer to BNY Nominees.

40 211. It is not possible to say that, because consideration was provided to BNY by HSBC in the form of collateral, that the process of raising capital was complete at the point the pre-release ADRs were issued. This is because under the terms of the Agency Agreement HSBC was not only liable to provide the collateral but also to

ensure the transfer of the HSBC shares to BNY Nominees (clause 2): therefore until those shares were transferred the process was not complete.

212. In conclusion the transfer of the shares from CTCNY to BNY Nominees was in fact a part of the capital raising process, as it was a part of the process by which  
5 HSBC provided the agreed consideration, the new securities, to its new investors. In this sense, it was integral.

*Optional process*

213. Nevertheless, it is also HMRC's case that even if the transfer was in fact a part of how HSBC ensured the new securities were issued to the new investors, nevertheless  
10 it was an entirely optional process and therefore not "integral" to capital raising. It was not essential, in order to raise the capital, that HSBC appointed CTCNY as exchange agent, thereby making inevitable the subsequent transfer of the shares from CTCNY to BNY Nominees on which SDRT was charged. As found above in  
15 paragraph 28, the transfer from CTCNY to BNY Nominees formed no part of the arrangements between HSBC and the former Household stockholders. The transfer from CTCNY to BNY nominees was not contemplated by the Merger Agreement.

214. We agree with HMRC that in this sense the transfer from CTCNY to BNY Nominees was not an essential part of the raising of capital, but, as we have said, we do not think that that is what the CJEU meant by "integral." The CJEU refers to the  
20 "transaction" and must have meant the transaction as a whole. So all the contracts should be considered as well as what actually happened.

215. The pre-release of the ADRs and the delay in the transfer of the HSBC shares from CTCNY to BNY Nominees to enable the flowback was clearly contemplated by HSBC shortly after the Merger Agreement was entered into (witness the clearance  
25 sought from HMRC) but it was only contractually provided for in the Exchange Agency Agreement (between HSBC and CTCNY) and dated the day of the merger and the Agency Agreement (between HSBC and BNY) and dated 5 days later.

216. We think that by "integral" the CJEU meant that the transfer must in fact be a part of the legal mechanism by which the company raising the capital (HSBC)  
30 actually conveyed the agreed consideration (the ADRs for those who elected for them) to the investors. Therefore our conclusion is that as a matter of fact the transfer from CTCNY to BNY Nominees *was* integral. This is because under the Merger Agreement HSBC was bound to honour the former Household stockholders' election for HSBC ADRs. Having immediately before the merger appointed CTCNY as  
35 exchange agent and then at the time of the merger allotted the shares to CTCNY, HSBC was thereafter bound to ensure that CTCNY transferred the appropriate number of HSBC shares to BNY Nominees.

217. The Agency Agreement with BNY was in fact entered into after the merger took place. Nevertheless this merely dealt with the pre-release of ADRs to enable the  
40 flowback arrangements. The liability to SDRT occurred on the transfer of shares from CTCNY to BNY Nominees and that transfer was inevitable once CTCNY was

appointed as exchange agent and was not dependant on whether or not the ADRs were pre-released. The effect of the Agency Agreement was, so far as the transfer from CTCNY to BNY Nominees was concerned, only to change (in some cases) the date on which it was made.

5 218. Therefore, we do not agree with HMRC that the transfer from CTCNY to BNY  
Nominees was optional from the point of the merger onwards: once the shares were  
issued to CTCNY it was inevitable. It was therefore in this sense also integral to the  
raising of capital. Although we agree with HMRC it was optional up to the point of  
the merger, we do not think that is material to whether it was integral. That HSBC  
10 could have done things differently does not mean it was not integral: the question is  
whether it was in fact a part of the transaction by which HSBC raised capital and we  
find it was.

219. We note that our conclusion would have been different if the terms of the offer to  
the Household shareholders were merely that they would be given HSBC shares, and  
15 that after the share for share exchange had taken place and not as part of the terms of  
it, HSBC offered the former Household stockholders the chance to exchange the  
HSBC shares for ADRs. In such a case the subsequent transfer of HSBC shares to  
BNY Nominees clearly would not be integral to the raising of capital by HSBC. It  
would not have been part of the transaction in which HSBC raised the capital as it was  
20 not part of the means by which HSBC paid the agreed consideration for the capital.  
But such were not the facts of the case before us.

#### *Motive*

220. It was not disputed that HSBC's motive in appointing CTCNY rather than BNY  
as exchange agent was to avoid SDRT on the ADRs which were cancelled soon after  
25 issue. This does suggest that the transfer was integral to the capital raising as the  
issue of the ADRs was the consideration provided to those former Household  
stockholders who elected for ADRs.

221. For the Appellants there is an irony in this case. Putting aside the issue of  
territoriality, had HSBC not attempted to mitigate the effect of SDRT on the issue of  
30 its shares by means of the flowback arrangements, and simply issued all the HSBC  
shares direct to BNY, the SDRT would have been repayable to them under a  
straightforward reading of the CJEU decision in *Vidacos*. It is particularly ironic for  
HSBC as the flowback arrangements were not in the event as successful in mitigating  
tax as expected: in *Vidacos* itself some 40% of the shares issued into the clearance  
35 system flowed back to the London Stock Market within 2 weeks. The figures in this  
case were much lower, possibly because institutional investors were expecting a  
flowback arrangement and were trying to capitalise on it.

222. But the test must be objective and so we agree with HMRC that HSBC's motive  
in appointing CTCNY rather than BNY as exchange agent is not relevant.

### *Conclusion*

223. Our conclusion, for the reasons given above, and applying the CJEU decisions in *Belgium* and *Vidacos*, is that the transfer of HSBC shares from CTCNY to BNY Nominees was integral to the raising of new capital by HSBC and therefore in taxing the *transfer* of shares from CTCNY to BNY Nominees, the UK Government was acting in contravention of Article 11 as the SDRT amounted to a tax on the issue of the HSBC shares.

### **Tax charge in breach of Article 10 CDD?**

224. The Appellants' case is that the SDRT is in breach of either or both Article 10 and 11. Article 10, cited above in paragraph 169, is broader than Article 11 and prohibits (apart from capital duty which both parties agreed – rightly – that SDRT is not) “any taxes whatsoever” on “an increase in the capital of a capital company by the contribution of assets of any kind.” Again it is the Appellants' case that SDRT should not have been levied in this case as it was charged on the transfer of shares from CTCNY to BNY Nominees and that transfer was an integral part of capital raising by HSBC.

### *The Reiss case*

225. The Appellants rely on the case of *Albert Reiss* [2007] ECR I-5357 and refer to what the Advocate General said:

20                    “[16] Directive 69/335 replaces the various types of indirect tax imposed by the Member States on the raising of capital by a single capital duty. This duty is to be charged only once on the basis of a harmonised structure and harmonised rates. The prohibition in Article 10 of other taxes with similar characteristics to the capital duty is intended to protect the system of a single capital duty and to ensure that it is not circumvented, either intentionally or unintentionally, by the introduction of such levies. This objective has clearly been the guiding principle of the Court in determining the scope of this provision.”

226. The facts in the *Reiss* case were that the sole shareholder (Mr Reiss) of the company (Reiss mbH) transferred to that company shares Mr Reiss owned in another company (Arku GmbH) in return for increased share capital in Reiss mbH.

227. The case concerned the legality of notarial fees charged on the authentication of the transfer of the shareholding in Arku GmbH. Part of the issue for determination by the CJEU (not relevant to this case) was whether notarial fees amounted to a tax. The CJEU concluded that they did.

228. The Court decided the fees were prohibited under Article 10(c) because they were a necessary formality in that they had to be paid if the capital was raised in a share for share exchange:

5 “[54] In [this] case....the fees in dispute were charged for the authentication of the transfer of shares in a company (Arku GmbH), made in the form of a contribution in kind in the course of an increase in the share capital of a capital company (Reiss mbH). The authentication in question thus attests a transaction on which the increase in the capital of a capital company is dependent. Since, under German law, such share transfer transactions must be authenticated, that authentication must be regarded as a formality which is necessary for carrying on the business of the capital company in question (Reiss mbH). The authentication in question is thus a prior formal requirement to which a capital company is subject by reason of its legal form.

10  
15 [55] It follows that fees such as those in dispute in the case in the main proceedings fall within Article 10(c) of Directive 69/335, which means that the charging of such fees is, in principle, prohibited.”

229. The CJEU also decided that Article 12(1)(a) did not relieve the illegality as it only applied to taxes and not notarial fees.

230.HMRC’s view is that the *Reiss* case shows that it is only “necessary” formalities that are relevant: the notarial fee had to be paid as part of the registration of the new capital (the shares in Arku GmbH). They distinguish it from this case as it was HSBC’s choice to use CTCNY as exchange agent.

231.This is misconceived. The CJEU’s reference to “necessary” is a reference to the payment of the notarial fees being necessary in the sense they were not optional and were therefore like a tax. Having chosen to raise capital by a share for share exchange, the liability to pay the notarial fees necessarily arose. The proper comparison with this case is that HSBC, having chosen to structure the transaction in the manner in which it did, was bound under UK domestic law to pay SDRT. *Reiss* is not authority for saying that a tax on a capital raising transaction is permitted by Article 10 of the Capital Duties Directive if the taxpayer (or person paying the tax as in this case) could have avoided it had it chosen to structure the capital raising transaction differently.

232.The true question arising from *Reiss* is, therefore, as the SDRT was charged on the transfer from CTCNY to BNY Nominees, whether that transfer was “in the course of an increase in the share capital of a capital company” (HSBC)? Was the transfer something on which “the increase in the capital of a capital company [was] dependent”? We think that the answer to these questions posed by the CJEU in the *Reiss* case must be the same as we gave in respect to Article 11 in paragraphs 223 above. The transfer was in the course of HSBC’s increase in share capital because it was part of the mechanism HSBC employed to deliver the agreed consideration (the option of HSBC ADRs) to the investors (the former Household stockholders) who were contributing capital (the assets and liabilities of Household).

233.Was the increase in capital dependent on this transfer? It was not dependent in the sense it was optional: HSBC could have met its obligations to the former Household stockholders differently (by using BNY as the exchange agent and

foregoing the flowback arrangements). However, as we have said with the meaning of “integral”, we do not think (for the reasons given in paragraphs 216 and 218) that the CJEU employed the term “dependent” to mean that no alternative structure could have been utilised by HSBC. The question is whether the structure that was *actually*  
5 used was dependent on that transfer and we find it was: having issued the shares to CTCNY, HSBC was bound by its contracts to ensure that CTCNY transferred the appropriate number of HSBC shares to BNY Nominees.

234. We conclude that the SDRT was therefore also unlawful under Article 10.

*The Codan and Fortum cases*

10 235. As mentioned above in paragraph 204, HMRC’s case is that *Skatteministeriet v Aktieselskabet Forsikringselskabet Codan* [1998] ECR I-8679 C-236/97 shows that in the view of the CJEU, even if an event is contractually pre-determined as part of the capital raising transaction, this does not mean that it is integral to the capital raising.

15 236. The facts in *Codan* were that there was a true share for share exchange. Shares in the target company (Fjerde Soe) were transferred by the 3 shareholders of Fjerde Soe to the acquiring company (Codan), who in return issued new Codan shares to the 3 former shareholders of the target company. Under Danish law, Codan was liable to pay capital duty under the Capital Duties Directive on the issue by itself of its new shares to its new shareholders. Codan was also liable to pay tax on the transfer of the  
20 target company’s shares to itself.

237. It was not suggested in the opinion of the Advocate General nor in the decision of the CJEU that the tax on the transfer of the shares was unlawful under Capital Duties Directive articles 10 or 11. It was not actually suggested it was tax on a capital raising transaction. Rather the case was about the proper interpretation of Article 12 and in  
25 particular whether the tax permitted on *transfers* in Article 12 was limited to a tax on transfers of *quoted* shares.

238. HMRC compare the transfer of the Fjerde Soe shares to Codan to the transfer of the HSBC shares by CTCNY to BNY Nominees. Both took place as a term of the contracts surrounding an increase in capital and in that sense both were integral.  
30 Therefore, say HMRC, it does not matter that the transfer from CTCNY to BNY Nominees was bound to happen under the contracts entered into to put into effect the merger. That does not mean, they say, it is integral. Because if it was, the CJEU in *Codan* would have ruled that the tax on the transfer of the Fjerde Soe shares was unlawful as it was clearly integral to the raising of capital in that the Fjerde Soe shares  
35 were the capital which was raised.

239. We do not agree with HMRC on this for two reasons.

240. Firstly the *Codan* case appears to be inconsistent with the later *Reiss* decision of the CJEU. It is inconsistent because, like the *Codan* case, *Reiss* involved a tax (actually notarial fees) on the transfer of shares in the target company (see paragraph  
40 227 above). In both cases the charge arose on the transfer *in* of shares in

consideration for the issue of new share capital. In both cases it appears the charge would have occurred on any transfer of shares. For this see the recital of facts by the Advocate General Geelhoed in *Reiss* in paragraph 20 of his Opinion which clearly indicates that the notarial fees were chargeable on any transfer of the shares:

5                    “[20] The charge at issue in the main proceedings is imposed in respect  
of the notarial attestation of the transfer of shares by members of the  
capital company....As such, the charge imposed ...would, therefore,  
appear to fall outside the terms of Article 10(c) of Directive 69/355.  
10                   However, this result is not justified in the light of the circumstances of  
the present case in which there is a direct legal and economic  
relationship between the transfer of shares and the increase of the  
capital of ARB mbH. I agree with the Commission, that, in this  
situation, the transfer of shares must be regarded as an integral part of  
the capital increase operation...”

15                   It is comparable to the *Codan* case where the stamp duty was charged on any transfer  
of shares, and not just on one which took place as part of a share for share exchange.

241. The *Reiss* decision must be preferred as the CJEU actually considered Article 10  
in that case. In *Codan* the CJEU was not asked to consider if the tax breached Article  
10 or 11.

20                   242.HMRC also drew our attention to the CJEU decision in *Fortum Project Finance*  
*G2 SA C-240/06 [2007]*. This decision was a few months after the decision in *Reiss*.  
A company called Fortum proposed to transfer the shares it owned in Fortum Heat  
and Gas to Fortum Project Finance in return for the issue of new shares to it. Finland  
charged tax on the transfer of shares. Capital transfer tax was also payable on the  
25                   issue of the new shares. The facts were therefore very similar in so far as relevant to  
the facts of the *Codan* case.

243.Fortum considered this was double taxation and challenged the legality of the tax  
on the share transfer. The CJEU did not agree and ruled:

30                   “[41] ..the transaction at issue in the main proceedings falls within the  
scope of Article 12(1)(a), so that the charging of capital transfer tax is  
covered in this case by that provision.

35                   [42] Furthermore, for the reasons set out by the Advocate General in  
points 67-70 of his Opinion, such an interpretation is consistent with  
*Codan*, in which the court held in circumstances identical to those in  
the main proceedings, Article 12(1)(a) of Directive 69/335 allows a  
duty to be charged in the event of a transfer of shares, in addition to the  
capital duty applicable as a result of the increase in share capital.”

244.However, as in *Codan*, Articles 10 and 11 were not referred to in the reference by  
the national court nor (apart from in a recital of the applicable legislation) in the  
40                   decision of the CJEU. The *Reiss* case was not considered. The *Codan* and *Fortum*  
cases are therefore binding decisions on Article 12 but not on Articles 10 or 11 for the  
simple reason that the CJEU made no decision in those cases on those two Articles.

245. We are however bound by the interpretation of Article 10 given in the *Reiss* case: but as *Codan* and *Fortum* did not consider Articles 10 and 11, *Reiss* did not consider to what transfers Article 12 applied (see paragraph 229). We are bound by the CJEU's interpretation of Article 12 given in *Codan* and *Fortum*.

5 246. So we move to the second reason for disagreeing with HMRC and that is that  
*Codan* and *Fortum* are clearly distinguishable from the present case. The distinction is  
between the consideration given by the capital raising company and the securities  
transferred in exchange for it. The Fjerde Soe shares were the capital raised by  
Codan, in the same way that the Household shares were the capital raised by HSBC.  
10 If the CJEU's decision in *Codan* is to be taken as implied authority that the tax on the  
transfer of the Fjerde Soe shares was not in breach of Articles 10 and 11, then our  
opinion is that the reason would be that it was a tax on new capital provided in kind.  
What if *Codan* or HSBC had raised cash instead of shares from their new investors,  
and then used that cash to buy shares in the target company? There could be no  
15 suggestion that any stamp duty on the transfer of the shares in the target company  
could be a breach of the prohibition in Articles 10 and 11 on tax on capital raising  
transactions.

247. In conclusion, applying the CJEU authority in *Reiss*, the SDRT charged on the  
transfer from CTCNY to BNY Nominees was unlawful under Article 10 of the  
20 Directive because that transfer was "in the course of an increase in the share capital of  
a capital company". But *Codan* provides that "Article 12(1)(a) ... allows a duty to be  
charged in the event of a transfer of shares, in addition to the capital duty applicable  
as a result of the increase in share capital." Therefore, *Codan* and *Fortum* may well  
be authority that a tax on the contribution of shares to the capital raising company is  
25 permissible under Article 12: but that is irrelevant in this case where the SDRT was  
not charged on the transfer (more accurately a cancellation) of the Household shares.  
The cases are not authority that contractually pre-determined transfers may not be  
"integral" to capital raising within Articles 10 or 11 because they are not authority on  
those articles. We move on to consider in detail whether Article 12 of the Capital  
30 Duties Directive applies to legalise the SDRT.

### **Does Article 12 apply to legalise the charge?**

248. As cited above at paragraph 171, Article 12 provides that "Notwithstanding  
Articles 10 and 11, Member States may charge...duties on the transfer of  
securities...".

#### 35 *The demarcation approach*

249. The appellants' case is that there are two ways of interpreting Article 12. Either  
(in their words) Article 12 delimits Articles 10 and 11. By this they mean a  
transaction falls into either 10/11 or 12 but not both. Or Article 12 is a derogation  
from Articles 10 and 11. If this latter interpretation is right a transaction can fall into  
40 both 10/11 and 12 and so a tax unlawful under 10 or 11 may be saved if the  
transaction falls into 12.

250. On the demarcation approach the Appellants says that clearly the transfer of shares by CTCNY to BNY Nominees was part of the increase in capital of HSBC and therefore within Articles 10 and 11 and cannot be saved by Article 12; if the derogation approach is correct then it still can't be saved by Article 12 because it did not involve a true transfer of shares occurring after and separately from the original issue.

251. The Appellants contend that the demarcation interpretation is correct and in support of this view cite the Opinion of the first Advocate General in *Reiss* at paragraph 30 where he says:

10                   “Following this line of reasoning, it would seem that to permit, under Article 12 of the Directive, the imposition of a charge which has been found to constitute an indirect tax on the raising of capital within the meaning of Article 10 of the Directive, would deprive the latter provision of its purpose. It is for this reason that I consider that Article 12 cannot be regarded as a derogation from the prohibition contained in Article 10. Rather, it demarcates the scope of that provision by indicating categories of duties which by their nature will not impede the raising of capital.

15  
20                   In the light of the interpretation given above to Article 10(c) of the Directive 69/335, Article 12(1)(a) of the directive cannot, therefore, exempt duties on the authentication of transactions which are economically and legally connected with the raising of capital or with the increasing of the capital of a capital company. It can only apply to duties on the transfer of shares where no such relationship exists. If Article 12(1)(a) were to be interpreted otherwise, this would risk undermining the effectiveness of the system of the single capital duty introduced by Directive 69/335.” (our emphasis)

252. The case was sent back for a second opinion for an unrelated reason and the next Advocate General (Trstenjak) expressed similar views as she said:

30                   “[58] It follows that Articles 10 and 12 of the Directive must be mutually exclusive, with the consequence that a charge falls under Article 10 or Article 12...

35                   [63] ...I am of the view that in a teleological approach to Article 12 authorises taxes or duties only in situations which have no connection to an increase in capital of a capital company.”

253. However, in its decision the CJEU neither expressly approved nor disapproved of the Advocate Generals' views on demarcation. But the Court impliedly disapproved it because at paragraph [55] they found the fees to be within Article 10 of the Capital Duties Directive and (see paragraph 228 above) the charging of the fees therefore to be 'in principle' prohibited and then the CJEU went on to consider whether nevertheless Article 12 permitted the tax. This is the 'derogation' view of the relationship between the three articles. Article 12 also indicates the derogation view is correct as it commences with the words "Notwithstanding Articles 10 and 11..." implying it is a derogation from those earlier Articles.

254. We return to this issue in paragraph 273.

*Article 12 to be narrowly construed*

255. The CJEU in *Reiss* did state that:

5                   “Since Article 12(1)(a) of Directive 69/335 limits the prohibitions laid down in Articles 10 and 11 of that directive, it must be strictly interpreted....”

256. In the *Belgium* case the CJEU ruled:

10                   “(paragraph 37)...the argument that the tax on stock exchange transactions is a duty on the transfer of securities, within the meaning of Article 12(1)(a) of Directive 69/335, which must therefore benefit from the derogation under that provision, it is appropriate to observe that, like any exception, that derogation must be strictly interpreted and cannot result in the principle from which it derogates being deprived of any practical effect.”

15   257. We therefore agree with the Appellants that Article 12 is to be narrowly construed, although we also agree with HMRC that it cannot be so narrowly interpreted as to be deprived of all meaning.

*Purposive construction*

20   258. We agree with the Appellants that we should look at substance over form when construing Article 12 (or indeed any other article of an EU Directive). The *Aro Tubi Trafilerie* [2006] ECR I-3009 C-46/04 case concerned a ‘reverse merger’ by which a subsidiary acquired its parent company. Italian law required that such transactions were subject to registration duty of 1% of the assets acquired and the CJEU say :

25                   “[26]...it is settled case-law that the nature of a tax, duty or charge must be determined by the Court, under Community law, according to the objective characteristics by which it is levied....”

30   259. We agree with HMRC that that case did not concern any question which is an issue in this case, but the principle is still applicable. We also agree that the Capital Duty Directive, as with all other directives of the EU, is to be given a purposive interpretation. This is demonstrated in the case of *Fuerzas Electricas de Catalunya C31-97*. That case concerned a tax on the repayment of debenture loans. Article 11B however only prohibited duty on the *issue* of debenture loans. Again the case did not concern the same article as this case. Nevertheless the principles hold good. The CJEU ruled:

35                   “[18]It is thus true that Article 11(b) of the Directive does not expressly mention the repayment of debenture loans; nevertheless, prohibiting the levying of duty when debenture loans are issued but authorising it when such loans are repaid would have the effect, contrary to the objective pursued by the Directive, of taxing loans as  
40                   overall operations for raising capital.

[19] It follows that Article 11(b) of the Directive must be interpreted as meaning that the prohibition of taxation on debenture loans extends to taxation on the repayment of such loans.”

260. Thus, we agree with the Appellants that the CJEU will give a purposive construction of the Directive even if that means departing from the ordinary meaning of words. The CJEU does not give a literal interpretation of an article of a directive where to do so would defeat the object of the directive.

261. So applying the principles that the Directive must be given a purposive interpretation and in addition that Article 12 should be narrowly construed, does that mean that a transfer in the circumstances of the transfer of the HSBC shares by CTCNY to BNY Nominees Limited is outside the scope of Article 12?

*Can a transfer be outside Article 12?*

262. The interaction of Articles 11 and 12 was considered by the CJEU in the *Vidacos* case, and their decision, continuing the quotation above in paragraph 191, was:

[34] To interpret the term ‘transfer’ referred to in Article 12(1)(a) of the directive in a way such as that proposed by the United Kingdom government ....., namely that SDRT at the rate of 1.5% is a charge on share transfers in the form of a ‘season ticket’, would effectively deprive Article 11(a) of the directive of its practical effect and call in question the clear distinction established by Articles 11(a) and 12(1)(a) of the directive between the concepts of ‘issue’ and ‘transfer’. In fact, such an interpretation would have the consequence that issues could nevertheless be subject to a tax or duty, although they, while necessarily involving an acquisition of newly issued securities, must not, under that provision, be subject to any taxes or duties other than capital duty.

[35] Therefore, the initial acquisition of securities immediately consequent upon their issue cannot be considered to constitute a ‘transfer’ within the meaning of Article 12(1)(a) of the directive, and, accordingly, a tax on that initial acquisition cannot fall within the derogation under that provision.....

[36] ....

[37] In the light of those considerations, it must be held that, to the extent that a tax such as SDRT is levied on new securities following an increase in capital, such a tax constitutes taxation for the purposes of Article 11(a) of the directive which is prohibited by that provision.”

263. This does not necessarily resolve the issue in this case. The CJEU were here dealing with the season ticket argument (referred to above in paragraph 190) that the SDRT was a charge on future (as yet uncertain) transfers within the Sicovam clearance system. They rejected HMRC’s case that it was a charge on these future transfers.

264. The CJEU did not expressly deal with a situation, such as in this case, where the tax is levied on a transfer that has already taken place (from CTCNY to BNY

Nominees). It is, of course, implied in their decision (see for instance paragraph 31) that the issue of the HSBC shares involved their transfer to the original investor so to this extent their decision was that a transfer could be part of the issue and therefore the tax charge on it not relieved under Article 12.

5 265. Should that part of their decision be extended to a transfer which, although integral to the capital raising, and integral to the issue of the ADRs, was not an integral part of the issue of the HSBC shares?

266. HMRC's point is that to allow the transfer from CTCNY to BNY Nominees to be part of an "issue" and not a transfer within Article 12 is to artificially limit the scope of Article 12. It would require, says HMRC, ignoring the legal reality of what happened. HSBC shares were transferred between two parties neither of whom was the issuer.

267. HMRC objects to what it sees as an overly extensive interpretation of "issue" in Article 11 so that it negates the effect of Article 12. HMRC agrees that the Directive must be interpreted purposively as this is what the CJEU does: but the interpretation cannot be so broad as to fail to implement the overall scheme of Articles 10, 11 and 12. Article 11 exempts "issue" but Article 12 allows taxation of "transfers". Therefore, "issue" cannot include "transfer" say HMRC. The fact a transfer is economically and contractually connected to an issue is not enough to make transfer a part of the issue. *Commission v Belgium* should be limited to the first acquisition of newly issued shares: had the CJEU not decided this it would have meant Article 11 had no scope: that does not mean they will interpret Article 12 so that it would have no scope.

268. We do not agree. HMRC's interpretation of *Belgium* and *Vidacos* amounts to saying that the only transfers the tax on which is held unlawful under Article 11 are those transfers where, to hold otherwise, would make Article 11 meaningless. On the contrary, it is Article 12 and not Articles 10 and 11 that should be narrowly interpreted. The Appellants' interpretation of Article 12, however, is that transfers which are integral to the raising of capital are not within 12. Such an interpretation is consistent with the CJEU's views in respect of Articles 10 and 11 and does not (contrary to HMRC's submission) deprive Article 12 of all application. On the contrary, Article 12 would continue to apply to any transfers of a security by the person who contributed capital to a subsequent investor and any transfer of the security subsequent to that. The UK Government may choose not to charge stamp duty on subsequent transfers of ADRs but it is permitted to do so by Article 12.

269. But is this the correct line to draw between Articles 10 and 11 and Article 12? As already stated, the CJEU in *Reiss* implied that a transfer could fall both within Articles 10 and Articles 12. The Appellants point out that the Advocate General in *Belgium* saw the distinction between Article 10/11 and Article 12 to be that Article 12 only relates to true transfers (paragraph 40) and not transfers which are connected with the raising of capital (paragraph 43). A similar view was expressed by the Advocate General in *Vidacos* at paragraph 42. But these views were not expressly adopted by the CJEU. Rather, the Court's view of why Article 12 did not apply to the

SDRT in *Vidacos* was that a contrary interpretation really would deprive Article 11 of all meaning as the first issue of a new security necessarily involves its transfer: see paragraph 34.

5 270. That does not resolve this case. While we have found the transfer from CTCNY to BNY Nominees to be integral on the facts of the particular case to the capital raising transaction, it was not necessarily involved in the sense that HSBC could have structured it differently. A decision that Article 12 did apply in this case would not deprive Article 11 of all meaning as it would continue to relieve from tax transfers in the more straightforward cases such as *Belgium* and *Vidacos*.

10 271. Our opinion is that in *Vidacos* in paragraph 37 (cited above in paragraph 262), by saying “in the light of these considerations” and referring to a tax “on new securities following an increase in capital”, the CJEU was reiterating its conclusion in paragraphs 31-33 as well as 34-36 and that therefore in our opinion (notwithstanding that the CJEU has not expressly upheld the demarcation view) a tax on an integral  
15 part of the overall capital raising transaction is not only unlawful under Article 11 but not relieved by Article 12. This is because otherwise the purpose of Articles 10 and 11 would be (at least in respect of this transaction) be defeated.

272. Therefore, because we have found that the SDRT on the transfer from CTCNY to BNY Nominees of the HSBC shares was an integral part of the overall capital raising  
20 transaction entered into by HSBC and therefore unlawful under Articles 10 and 11, it is not relieved by Article 12. We accept that this means giving something other than a literal reading to Article 12 as it involves relieving a transfer from tax, but it is clear from *Fuerzas Electricas de Catalunya* that it is right to do this where to do otherwise would defeat the purpose of the legislation. In this case a tax on a transfer which we  
25 consider was integral to the capital raising transaction would defeat the purpose of the Directive.

273. We recognise that such a view appears to adopt the demarcation argument put forward by the Appellants and referred to by us in paragraphs 249-254 above. However, we think that the proper view is derogation because some transfers can be  
30 within both Articles 11 and 12, although not the transfer in this case. In particular the transfer to the capital raising company of the new capital is within Article 10 (see *Reiss*) but nevertheless such a transfer would be relieved by Article 12 (*Codan* and *Fortum*). But where the charge is effectively on the issue of the new securities themselves it is both unlawful under Article 11 and not relieved by Article 12:  
35 *Vidacos* and *Belgium*.

*What if the new ADR holders had retained a beneficial interest in the underlying shares?*

40 274. The entire section above considering the EU law implications was on the basis of our finding set out in paragraph 149 that the former Household stockholders who elected for HSBC ADRs did not, once they received the ADRs retain a beneficial interest in HSBC shares. But as we said we would, we briefly consider whether our

view on EU law would be any different had we come to a different conclusion on this question.

275. Not surprisingly, as our conclusions on EU law is that the SDRT charge on the transfer from CTCNY to BNY Nominees was unlawful, had we decided the question on beneficial interest in favour of the Appellants, our view would also have been, but more forcefully, that the SDRT charge was unlawful.

276. Firstly, referring back to the question of who was the “first investor” clearly (had the beneficial interest not moved) the former Household stockholders would not only have been the first investor, it would not be right to view BNY as the second investor as BNY would take no beneficial interest in the shares. Although we conclude in paragraph 198 that “who is the first investor” is the wrong question, nevertheless this point only adds force to the view that SDRT should not be charged on the transfer of mere legal title.

277. Our other conclusions in regards Articles 10 & 11, such as with respect to completion of the raising of capital and integral/optional would remain unchanged.

278. In respect of Article 12 and the question whether the tax was permitted as a tax on transfer, our views would remain unchanged but in addition we would note that it is most unlikely that “transfer” in Article 12 should be read as exempting a tax on a transfer of bare legal title alone as part of a transaction which otherwise fell within Articles 10 & 11.

279. We note that in any event we have agreed with the Appellants that on any view the transfer by CTCNY to BNY Nominees was a transfer of bare legal title. It was not in dispute that CTCNY and BNY Nominees were bare trustees or custodians. The distinction between the Appellants’ case and our finding is that on the Appellants’ view *only* legal title moved. We have found, on the contrary, that beneficial title to the transferred shares also moved at the time of the transfer of legal title although not between the same persons. In these circumstances, we do not think the CJEU would view the SDRT as a tax on a bare transfer of title and outside Article 12. Nevertheless we have, for other reasons, reached the view that they would regard Article 12 as inapplicable to the SDRT charge in this case.

### **Territorial scope of the Capital Duties Directive**

280. That does not conclude the case, because HMRC question whether Articles 10 and 11 of the Capital Duties Directive actually apply to the issue or transfer of shares to a person established outside the European Union in connection with the issue outside the EU of ADRs in respect of those shares.

281. HSBC is a company incorporated in an EU Member State. HSBC is the company which raised the capital. The shares were issued to CTCNY (a US company) and then transferred to BNY Nominees (an EU company). BNY Nominees was the nominal recipient of the HSBC shares but BNY (a company incorporated under the law of New York) issued the ADRs to the investors. We had no evidence on the actual

location of the former Household stockholders (the investors) but the implication of the evidence was that many holders of ADRs would be private individuals located in the US (because they probably chose the ADRs because, unlike HSBC shares, they are tradeable on the New York stock market).

- 5 282.As mentioned above, there are two issues arising under Article 11. The one is the issue of the HSBC shares and the other is the issue of the ADRs . Both raise issues of territoriality.

*The issue of the HSBC shares*

- 10 283.On their face, Articles 10 and 11 say nothing of their territorial scope. Article 11 prohibits tax on the issue of securities “by whomsoever issued” and Article 10 prohibits a charge to tax “with regard to companies, firms, associations or legal persons operating for profit...”. No mention is made in either Article that the prohibition extends only in so far as the person issuing the security is issuing it to persons located in the EU.

- 15 284.In the Directive, there are some express territorial restrictions such as in Article 2(1) which provides that capital duty “shall only be taxable in the Member State in whose territory the effective centre of management of a capital company is situated at the time when such transactions take place”.

- 20 285.HMRC’s point is that Article 2 shows that the drafters were aware that territoriality was an issue and therefore any absence of an express provision for extra-territoriality indicates that none was intended. We cannot agree. Firstly, Article 2 deals with intra-EU territoriality: it is needed to avoid the possibility that two or more Member States might seek to raise capital duty on the same transaction. Secondly, to limit the scope of the Directive to capital raised from EU investors would give rise to inevitable and predictable difficulties as many companies would have investors from  
25 locations both within and outside the EU that, had such a restriction on the scope of the Directive been intended, it would have been express.

*The preamble*

- 30 286.We have already mentioned that the CJEU has said that the Capital Duties Directive must be given a purposive construction. We therefore turn to the preamble of the Directive to discern its purpose with respect to its territorial application. This provides as follows:

35 “Whereas the objective of the Treaty is to create an economic union whose characteristics are similar to those of a domestic market and whereas one of the essential conditions for achieving this is the promotion of the free movement of capital;

40 Whereas the indirect taxes on the raising of capital, in force in the Member States at the present time, namely the duty chargeable on contribution of capital to companies and firms and the stamp duty on securities, give rise to discrimination, double taxation and disparities

which interfere with the free movement of capital and which consequently must be eliminated by harmonisation;

5 Whereas the harmonisation of such taxes on the raising of capital must be arranged in such a way as to minimise the budgetary repercussions for Member States;

10 Whereas the charging of stamp duty by a Member State on securities from other Member States introduced into or issued within its territory is contrary to the concept of a common market whose characteristics are those of a domestic market; whereas, in addition, it has become evident that the retention of stamp duty on the issue of securities in respect of internal loans and on the introduction or issue on the market of a Member State of foreign securities is both undesirable from the economic point of view and inconsistent with current developments in the tax laws of the Member States in this field;

15 Whereas, in these circumstances, it is advisable to abolish the stamp duty on securities, regardless of the origin of such securities, and regardless of whether they represent a company's own capital or its loan capital;

20 Whereas it is inherent in the concept of a common market whose characteristics are those of a domestic market that duty on the raising of capital within the common market by a company or firm should be charged only once and that the level of this duty should be the same in all Member States so as not to interfere with the movement of capital;

25 Whereas, therefore, this duty should be harmonised, with regard both to its structures and to its rates;

30 Whereas the retention of other indirect taxes with the same characteristics as the capital duty or the stamp duty on securities might frustrate the purpose of the measure provided for in this Directive and those taxes should therefore be abolished;"

287.Preamble 4 contains an express reference to the intended territorial scope of the Directive. It provides that "the retention of stamp duty....on the introduction or issue on the market of a Member State of foreign securities is both undesirable....". This clearly indicates that the Directive was intended to be global in so far as securities are issued into the EU. But what of securities issued by an EU-based company to non-EU based investors?

288.HMRC consider that the preamble strongly indicates a restricted territorial scope. They point out that preamble 4 gives three reasons for the abolition of stamp duty and only one expressly relates to inter-EU movements. They also say that the preamble indicates a restricted scope as one of the objectives is the realisation of a "common market whose characteristics are those of a domestic market" thus implying no extra-territorial effect is intended. We cannot agree.

289.We find the whole tenor of the preamble presupposes that it applies to the raising of capital by any company situated in the EU. Contrary to what HMRC say, as Preamble 1 says that its object is to "create an economic union whose characteristics

are similar to those of a domestic market” this must indicate that one of its purposes was to treat all EU companies alike irrespective of the particular Member State in which they were situated. It goes on to say that a condition for achieving this is “the free movement of capital” and it is obvious that free movement of capital is prevented if one Member State is permitted to raise stamp duty on transactions raising capital from anywhere else in the world but another chooses not to. Something akin to a domestic market across the EU is only achieved if all companies within that market are subject to the same rules of taxation.

290.If there were any doubt that this is what preamble 1 means, it is expressly stated in preamble 2: “the indirect taxes on the raising of capital, in force in the Member States at the present time, namely the duty chargeable on contribution of capital to companies..., give rise to discrimination, double taxation and disparities which interfere with the free movement of capital ....” And such taxes, says Preamble 2, “must be eliminated”. The purpose of the Directive must therefore have been to eliminate them.

291. Preamble 5 goes on to say “it is advisable to abolish the stamp duty on securities, regardless of the origin of such securities”. Now it seems fairly obvious, as it follows Preamble 4, that it is actually referring to stamp duty on the issue of securities and not stamp duty on the transfer of securities, nevertheless it is clear it intends to abolish stamp duty on the issue of securities into the EU and clearly implies, as it goes without saying, that securities the issue of which is within the EU should also be free of stamp duty.

292.And if there were any doubt about this, preamble 6 provides that that “duty on the raising of capital within the common market by a company or firm should be charged only once and that the level of this duty should be the same in all Member States so as not to interfere with the movement of capital;” clearly virtually expressly saying that *only* capital duty authorised by the Directive could be charged on the raising of capital by companies within the common market.

293.Preambles are not part of the operative legislation and should not be interpreted as if they were, but it seems to us that the drafters of the Directive here must have intended the phrase “raising of capital within the common market” to mean the raising of capital by a company situated within the common market. Article 2 makes it clear that capital duty is chargeable on companies to the extent they are situated within the EU. Its application is not restricted to raising of capital from investors located within the EU. It would be very odd if it did so as this is contrary to the preamble and would involve enormous practical difficulties in identifying the location of all the investors.

294. In conclusion, the argument over whether the Directive was intended to be extra-territorial in scope (although it clearly was in some respects) may be sterile. The question is whether it was intended to apply to companies situated in the EU, or whether (as contended by HMRC) it was only intended to apply to companies situated in the EU in so far as they were raising capital from investors based in the EU. We are in no doubt it was intended to apply to companies situated in the EU irrespective of where their investors were located. It would seem contrary to its expressed objects

to limit it to capital raising transactions where the investors were also situated in the EU and in any event it does not expressly do so.

295. The Appellants go on to say that the Directive should also be interpreted in light of Article 56 (now 63) of the EC Treaty. Apart from issues referred to later in paragraph 316 about whether the Treaty can be referred to when interpreting the Directive, HMRC also say that the Directive was made under Articles 93 and 94 of the Treaty and has no need to be construed to be consistent with Article 56 and in any event Article 56 only came into existence with the Treaty of Maastricht on 1 January 1994 and post-dates the Directive. It cannot therefore have been intended by the drafters of the Directive to be consistent with Article 56.

296. We think that this is rather narrow. The Directive was not repealed when the Treaty of Maastricht was adopted. We can therefore safely assume that it was seen by the European Council as consistent with the Treaty of Maastricht. Also it does not matter under which provision the Directive was made: it cannot have been intended to conflict with any provision of the Treaty as indeed there is no power on the EU legislature to pass any law in conflict with the Treaty.

297. If we are to interpret the Capital Duties Directive to be consistent with the Treaty, then clearly the Capital Duties Directive must be taken as applying to any EU company raising capital from investors anywhere in the world. We have already said that this would be the interpretation of the Capital Duties Directive based on its own preamble: the prohibition on restrictions on movement of capital between Member States and the rest of the World in Article 56 would put it beyond doubt as it provides:

“(1) Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

(2) Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.”

298. However, HMRC’s case is that the Capital Duties Directive is not to be interpreted in the light of the Treaty. We do not agree with this for reasons explained below in paragraph 316. Our conclusion is therefore that because of the Directive’s preamble’s expressed intention to create a domestic market across the EU and the fact that it does not expressly limit the benefit of its provisions to those EU companies raising capital from EU investors and because the Directive should be interpreted with Article 56 in mind, we conclude that any EU company may benefit from the protection of Articles 10 and 11 irrespective of the location of its investors, or of the location of the transferee or transferor of the transaction for which the benefit of Article 10 and/or 11 is sought.

#### *Location of taxpayer*

299. The taxpayer is BNY. HSBC is an appellant by virtue of the fact that it has assumed liability to pay the tax as it is permitted to do under the law. HMRC’s point

is that to allow BNY rights under the Treaty is to give it extra-territoriality. BNY is not, they say, a company registered in the EU.

5 300. We reject HMRC's case on this. BNY is registered in the State of New York but it has a branch office in London and therefore a presence in the EU. Indeed, under s 93(8) of the Finance Act 1986 it is only the taxpayer in this case because it has a branch in the UK. If it had no presence in the UK, HSBC would have been the taxpayer.

10 301. In any event, we do not consider that the location of the taxpayer is determinative to the territorial scope of the Directive, although we are not aware of any CJEU decision on this. The point is that HSBC was the company which raised capital: it would defeat the object of Articles 10 and 11 if an EU government could circumvent them by imposing the tax liability on a company other than the one which raised the capital.

15 302. Finally, as a matter of practical if not legal reality, HSBC was the company which paid the tax. In order to raise the capital, it indemnified BNY and the stockholders against the tax.

303. For all these reasons, we think that BNY's registration outside the EU is irrelevant: the Capital Duties Directive applies because HSBC, the company which raised the capital, is a company registered in the UK.

#### 20 *Conclusion*

304. In conclusion, our opinion is that the Capital Duties Directive applies to this transaction and the SDRT levied on the transfer from CTCNY to BNY Nominees is unlawful under Articles 10 and 11 of that Directive and not relieved by Article 12.

#### *The issue of the ADRs*

25 305. Having concluded the above point in favour of the Appellants, strictly there is no need to consider the question of whether the issue of the ADRs was territorially within the scope of the Directive, but for the sake of completeness we deal with this point. The answer to this is not necessarily the same so far as the issue of the ADRs is concerned. We have concluded, putting issues of territoriality aside, that the SDRT was a charge on the issue of the ADRs as that issue was a prerequisite to liability (see paragraph 173-177) but that it was unlawful under Article 11 as a form of taxation on the issue of certificates representing shares.

35 306. The issuer was BNY a company registered and principally based in the US. Although we had no direct evidence, it is very likely that many if not most of the persons issued with the ADRs were private US citizens.

307. We have concluded above that, so far as the issue of the HSBC shares is concerned, as they were issued by an EU company (HSBC), the territorial scope of the Directive is not really an issue: there is nothing in the Directive to suggest that it

was intended to be limited to issues to investors based in the EU. However, the territorial scope of the Directive is very much in point on the issue of the ADRs by a US bank.

308.Preamble 4 & 5 of the Capital Duties Directive provide

5                   “Whereas the charging of stamp duty by a Member State on securities  
from other Member States introduced into or issued within its territory  
is contrary to the concept of a common market whose characteristics  
are those of a domestic market; whereas, in addition, it has become  
evident that the retention of stamp duty ...on the introduction or issue  
10                   on the market of a Member State of foreign securities is both  
undesirable from the economic point of view and inconsistent with  
current developments in the tax laws of the Member States in this field;  
  
Whereas, in these circumstances, it is advisable to abolish the stamp  
duty on securities, regardless of the origin of such securities, ....”

15   309.This indicates that at least in so far as the ADR holders were based in the EU the  
SDRT charge was unlawful under the Directive (subject to the point raised in  
paragraph 176). However it is unlikely that many ADR holders were so based and if  
the decision in this appeal rested on the location of the ADR holders (which it does  
not), further facts would have to be found.

20   310.The Treaty, which we consider is relevant to interpretation of the Directive  
provides that “all restrictions on the movement of capital between Member States and  
between Member States and third countries shall be prohibited.” which again suggests  
that the SDRT charge could only be unlawful to the extent that the ADR holders were  
based in the EU. The fact BNY has a branch in London is not we think relevant: it  
25                   was not suggested that the ADRs were issued by the branch: indeed the only reason  
they ADRs were tradeable on the New York Stock Exchange was because they were  
issued by a US bank.

311.Our conclusion on this, therefore, is that in so far as the issue of the ADRs per se  
is concerned, the Directive (and indeed the Treaty) gives BNY no protection against  
30                   the SDRT charge except to the extent the Appellants can prove that the ADR holders  
(other than those that broke the ADRs in the flow back) were located in the EU. And  
then whether it gives any protection in that situation depends on the answer to the  
question we raised in paragraph 176. Although, as we conclude the point on the  
transfer of the shares from CTCNY to BNY Nominees in favour of the Appellants,  
35                   this point does not arise.

### **Application of Article 56 of the Treaty**

312.An alternative argument raised by the Appellants was that the SDRT charge was  
unlawful under the Treaty on European Union. (We note that since the facts at issue  
in this case this has been replaced by the Treaty of Lisbon but we refer to Article 56  
40                   of the Treaty in force at the time although it is no different to Article 63 of the current  
Treaty of Lisbon). The Appellants’ argument on Article 56 is only relevant if the  
SDRT charge was lawful under Article 12 of the Directive or if the Capital Duties

Directive had limited territoriality which meant it was not applicable to the transaction in this case. As we have concluded both these issues in favour of the Appellants, we only go on to consider the Treaty for the sake of completeness as the point was argued.

5 313. We have already referred to the Treaty above in a question of how to interpret the Directive. The Appellants' case goes further: they say that the Treaty has an application to their appeal entirely separately to the Directive. In other words, it is the Appellants' case that even if Article 12 did apply to legalise the charge under the Capital Duties Directive, that could not override the plain words of the Treaty that:

10                   “(1) Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.

15                   “(2) Within the framework of the provisions set out in this Chapter, all restrictions on payments between Member States and between Member States and third countries shall be prohibited.”

314. HMRC's case, however, is that the Treaty has *no* application. This is because the CJEU in *Vidacos* stated:

20                   “[25] As a preliminary point, it should be noted that the directive provided for complete harmonisation of the cases in which the Member States may levy indirect taxes on the raising of capital (see to that effect, Case C-178/05 *Commission v Greece* [2007] ECR I-4185, paragraph 31).

25                   [26] As the Court has already held, where a matter is harmonised at Community level, national measures relating thereto must be assessed in the light of the provisions of that harmonising measure and not of those of the EC Treaty (see, to that effect, Case C-324/99 *DaimlerChrysler* [2001] ECR I-9897, paragraph 32 and Case C-257/06 *Roby Profumi* [2008] ECR I-189, paragraph 14).

30                   [27] It follows that, in order to answer the question referred for a preliminary ruling, the Court must limit itself to interpreting the directive.”

315. The Appellants point out the Advocate General in *Vidacos* had stated the SDRT in that case was an infringement of Article 56 of the Treaty as well as of the Capital Duties Directive. This is paragraph 21 of the AG's opinion where he says:

35                   “[21] The compatibility with Community law of the 1.5% SDRT must be assessed – as has been pointed out, moreover, by the referring court in its question, from two standpoints. First, it is necessary to determine whether that tax is permissible in the light of Directive 69/335 and, in particular, in the light of arts 10 and 11 thereof, Second, it is also necessary to determine whether the tax in question can be reconciled with the fundamental freedoms provided for in the Treaty with respect to establishment, provision of the services and movement of capital, For reasons of clarity, I shall examine the two aspects of the problem separately.”

40

316. From paragraphs 25-27 of the CJEU’s decision, it is clear that this view was not endorsed by the CJEU. However, that is far from saying that the Treaty is not relevant. The CJEU did not say the Treaty was irrelevant to the question of the *interpretation* of the Capital Duties Directive, merely that it had no independent application in a situation where a Directive had fully implemented it. Indeed, logically, it must be relevant to the *interpretation* of the fully harmonising measure as how else could it be determined that it was a fully harmonising measure? And, secondly, the Treaty *is* potentially relevant to anything that was not harmonised by the Capital Duties Directive.

10 *What did the Directive harmonise?*

317. So the question is what did the Capital Duties Directive completely harmonise? In *Commission v Greece* [2007] ECR I-4185 the CJEU held that the Capital Duties Directive:

15 “harmonises exhaustively the cases in which the Member States may impose capital duty.”

318. This is repeated in different words in *Vidacos* (paragraph 25) where the CJEU considered that the Capital Duties Directive also harmonised completely “the cases in which the Member States may levy indirect taxes on the raising of capital”.

20 319. The Appellants consider that this puts HMRC in a position it is impossible to win: either the transaction from CTCNY to BNY Nominees was part of the raising of capital and one on which capital duty but no other tax could be raised, in which case SDRT was unlawful, *or* it was outside the transactions harmonised by the Directive because it was not charged on the raising of capital, in which case the Treaty applies. And in the Appellants’ view, the SDRT would be unlawful under the Treaty. We consider these issues in turn.

*Outside harmonisation?*

30 320. It is the Appellants’ primary case (which we have agreed with) that the transfer of shares from CTCNY to BNY Nominees in the particular circumstances of this issue of shares by HSBC and ADRs by BNY as part of HSBC’s acquisition of Household was within Articles 10 and 11 of the Directive and not within Article 12: it is also their case (which we have agreed with) that the Directive applies to all issues of shares by companies situated within the EU irrespective of the location of the investors.

35 321. But if the Appellants (or this Tribunal) are wrong on either or both of these points, then the transaction is *not* within the matters harmonised by the Directive. And the Treaty may apply. This is because Article 4 and Article 10 are in this sense mirror images. Article 4 originally required capital duty to be charged on certain events including (c) an increase in the capital of a capital company by a contribution of assets of any kind. (The other matters mentioned in Article 4 did not include transfers of shares but matters such as the formation of a company). Article 10 then prohibited any other taxes on the matters within Article 4.

322.HMRC take a different view. Their view is that (contrary to the Appellant’s demarcation view of Articles 10/11 and 12) if the Tribunal decided the transfer was within Article 10 or 11, nevertheless the SDRT was lawful under Article 12. Therefore, the transfer is both within Article 4 and Article 12: it is harmonised by the Directive, but SDRT on it is lawful, and the Treaty is not relevant.

323. We do not agree. A transfer within Article 12 is outside Articles 10 and 11 and the harmonisation of the Directive. In any event this appears to be the view of the CJEU in the *Fortum* case where the CJEU concluded that the tax on the transfer of the contribution of capital in the form of shares was permitted under Article 12, because the CJEU went on to consider whether Article 56 would have application:

“[27] It must be observed first of all that in this case there is no need to interpret Article 56 of the Treaty since the law on capital transfer tax imposes taxation rules which are identical for national and cross border transfers of securities. So that in so far as it may be inferred from the file submitted to the court, that measure does not have any direct or indirect discriminatory effect.”

In other words, in a case where the transaction was within Article 12, the CJEU did apply a two stage approach. The reason Article 56 did not apply to outlaw the tax in *Fortum* was that it was not discriminatory, not that the Treaty per se should not be considered.

324. Therefore, on the assumption the Tribunal is wrong on the conclusions it has reached under the Directive (as summarised in paragraph 304), we have to consider whether the SDRT on the transfer is prohibited by Article 56 of the Treaty.

#### *Breach of Article 56?*

325. Article 56 prohibits restrictions on the movement of capital. To decide whether Article 56 is breached, the CJEU apply a three stage test such as in *Glaxo* C-182/08 [2010] STC 244:

1. is there a restriction on cross border movement of capital? (see *Glaxo* paragraphs 53-59)
2. if so, does the relate to situations which are not objectively comparable or is it justified by an overriding reason in the public interest? (see *Glaxo* paragraph 68)
3. if there is such a justification, does it go beyond what is necessary to achieve that objective? Is the restriction necessary and proportionate to achieving that objective? (see *Glaxo* paragraph 100)

But the first question is what is a movement of capital within Article 56 of the Treaty?

#### *What is a movement of capital within Article 56?*

326. What are “movements of capital”? The now defunct Directive 88/361/EEC contains a non-exhaustive list, which is still referred to by the CJEU (see paragraph 39 of *Glaxo*). It is an extremely wide list and includes things that amount to capital

raising transactions such as “admission of securities to the capital market” but also includes transactions not connected with capital raising such as “transactions in securities on the capital market” which is defined to include “acquisitions by non-residents of domestic securities” and associated operations. It applies to many things not relevant to the case, such as loans, sureties and dowries.

327.The movement which was taxed, and is therefore the one on which the alleged unlawful restriction arises, was the transfer of HSBC shares by CTCNY (a US company) to BNY Nominees (a UK company). The CJEU expressly states in *Glaxo* that the sale of holdings in resident companies by non-resident investors is a movement of capital (paragraph 43). In this case the transfer was not on sale, but bearing in mind it is a wide and non-exhaustive list, the transfer of shares in a resident company by a non-resident investor to a resident investor must be a cross border movement of capital within the meaning of Article 56.

*Is there a restriction on cross border movement of capital?*

328.The Appellants consider the SDRT on the transfer to be a restriction on cross border movement of capital because the SDRT charge at 1.5% makes acquiring a new ADR less attractive than acquiring new shares with nil stamp duty and no SDRT.

329.HMRC’s case is that SDRT is not discriminatory in that it applies to any acquisition of a new ADR and therefore it is not a restriction on cross border movements of capital. They cite *Kerckhaert v Belgium* 2006 [ECR] I-10967 at §16-19 and *Test claimants in the FII group litigation* [2007] STC 326 in support of this proposition. In *Kerchhaert* at paragraph 19 the CJEU ruled:

“[19] ...discrimination may consist ...in the application of different rules to comparable situations but also in the application of the same rule to different situations...”

330.Article 56 of the Treaty is only relevant to this appeal if the Appellants’ case under the Capital Duties Directive was unsuccessful. Our opinion is that its case succeeds under the Directive but if we were wrong and it had failed solely because the Directive did not apply to issues of securities to non-EU investors (as HMRC claim) then the SDRT rules on their face would be discriminatory as SDRT would not apply to the transaction carried out by HSBC had the investors been based in the EU (*Vidacos*).

331.However, if the Appellants’ case had failed because the issue of the ADRs as structured in HSBC’s acquisition of Household meant that the transfer from CTCNY to BNY Nominees was within Article 12 (and/or outside Articles 10 and 11), then on the face of it SDRT would not be discriminatory as the SDRT would have been payable even if the transaction had taken place entirely within the UK.

332.However, the Appellants’ point is that in practice it would still be discriminatory because a UK company raising capital entirely within the UK would not cause ADRs to be issued. The whole purpose of the issue of the ADRs (or the issue of the HSBC shares into the Sicovam clearance service in *Vidacos*) was to allow foreign investors

to invest in a UK company yet hold securities that could be traded on a domestic market. Indeed the rationale of SDRT (as explained by HMRC in their submissions on the season ticket argument in *Vidacos*) is that it franks future transfers of these substitute securities which would otherwise escape stamp duty to which they would have been liable had they been transfers of the original securities. Is this discrimination as identified by the CJEU of the “same rule to different situations”? We think it is.

333.HMRC’s point on this, though, is that an interpretation of the Treaty that the tax is discriminatory is to deprive Article 12(1)(a) of the Capital Duties Directive of effect. We do not agree. *Non-discriminatory* taxes on transfers would be permitted by both Article 12 of the Directive and Article 56 of the Treaty. In conclusion, the SDRT charge in this case fails the three tests in *Glaxo* and were it not unlawful under the Directive, it would be unlawful under the Treaty.

*Objective or overriding reason for restriction?*

334.HMRC does not seek to justify the tax on the basis of effective fiscal supervision or indeed any other basis, not even the season ticket argument put forward in *Vidacos* in a different context. Therefore we do not find the restriction justified.

*Is restriction necessary and proportionate?*

335.Similarly HMRC do not seek to justify the restriction on the basis it was necessary and proportionate and we do not find it was necessary or proportionate.

*Grandfathering provisions*

336.HMRC’s final case is that if they are wrong and the tax is a breach of Article 56 of the Treaty nevertheless it is lawful under the grandfathering provisions of Article 57(1) of the Treaty. This provides:

“The provisions of Article 56 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Community law adopted in respect of the movement of capital to or from third countries involving direct investment – including in real estate – establishment, the provision of financial services or the admission of securities to capital markets.”

*Is it a movement of capital within Article 57?*

337.Unlike Article 56, Article 57 does not use the term “restrictions on the movement of capital”. Instead it refers (in so far as relevant) to “restrictions .... adopted in respect of the movement of capital to or from third countries involving ....the admission of securities to capital markets.”

338.HSBC shares are capital and the transfer from CTCNY (a US company) to BNY Nominees (a UK Company) involved the movement of capital from a third country: did it involve the admission of securities to a capital market?

339.HSBC's point is that the tax was imposed on the transfer of HSBC shares from CTCNY to BNY Nominees and this by itself did not involve the admission of securities to a capital market. Nevertheless, it was (as we have found earlier) an integral part of the overall transaction by which HSBC raised capital and the new  
5 HSBC shares were admitted to the London stock market and the HSBC ADRs were admitted to the New York Stock Exchange. Does that mean it was "involving" admission of securities to capital markets?

340.Article 57 is a derogation from Article 56 and unlike, Articles 10 and 11 of the Capital Duties Directive, is to be construed narrowly. The CJEU would not  
10 necessarily give Article 57 the same interpretation as they gave Article 11 of the Directive. Nevertheless, we consider that it would be too narrow to construe "involving" to exclude this transfer where it was connected with the issue of the ADRs and indeed without which (or without the promise of which in the case of the shares transferred under flowback) the ADRs would not have been issued.

15 341.Therefore, in our opinion, the transfer from CTCNY to BNY Nominees was a capital movement that did involve the admission of securities to a capital market and in principle Article 57 (were the Treaty relevant) would apply.

*Did the restriction pre-date 1994?*

20 342.However, to be within the grandfathering provisions the restriction, as we have now determined it to be, had to be in force before 1994. SDRT did apply before 1994, but there was an exemption. As at 31 December 1993, s95(3) & (4) FA 1986 provided:

25 "(3) There shall be no charge to tax under section 93 above in respect of an issue by a company (company X) of securities in exchange for shares in another company (company Y) where company X –

(a)has control of company Y, or

(b)will have such control in consequence of the exchange or of an offer as a result of which the exchange is made.

30 (4)For the purposes of subsection (3) above company X has control of a company Y if company X has power to control company Y's affairs by virtue of holding shares in, or possessing voting power, in relation to, company Y or any other body corporate."

35 With effect from 1 May 1998, s 151(1) Finance Act 1998 added the words "and the shares in company Y are held under a depository receipt scheme" to s95(3)(b) so that it read:

"(3) There shall be no charge to tax under section 93 above in respect of an issue by a company (company X) of securities in exchange for shares in another company (company Y) where company X –

(a)has control of company Y, or

(b)will have such control in consequence of the exchange or of an offer as a result of which the exchange is made and the shares in company Y are held under a depositary receipt scheme.

5 (4)For the purposes of subsection (3) above company X has control of a company Y if company X has power to control company Y's affairs by virtue of holding shares in, or possessing voting power, in relation to, company Y or any other body corporate."

343.HSBC and HMRC were agreed that the effect of this addition to s 95 was that, if the transaction was within the exemption contained in s 95 before this additional  
10 wording was inserted, it ceased to be so once the wording was in effect. This is because the shares in Company Y (Household) were not in a depositary receipt scheme. However, this restriction in the exemption occurred after 1994 and was not grandfathered. So it is clear that if the transaction happened after 1 May 1998 (as it did) it was subject to SDRT. We need to consider whether the SDRT charge would  
15 have applied had this transaction occurred on 31 December 1993 because if so the Treaty is inapplicable.

344.So the question for us is whether the exemption in s95 (as set out in paragraph 342 above) would have applied to the facts of this case before the amendment made in  
20 1998. HMRC's case is that the transaction was not a share for share exchange but a merger. HSBC issued shares but did not receive Household shares in return. Household shares were cancelled at the moment of merger. HSBC (or rather its wholly owned acquisition company, H2) received Household's assets and liabilities.

345.This is a question of interpretation of English law: what is the meaning of s95(3) &(4) of Finance Act 1986 as it existed in 1993? Was there a share for share  
25 exchange? And if there was, did HSBC acquire control of Household as a result of it?

346.Control of company Y's affairs? Dealing with s95(3)(b) first, the exemption applies only where Company X (HSBC) "will have ...in consequence of the exchange" "control of company Y"(Household.)

347.Section 95(4) defines controls as including the "power to control [Household's]  
30 affairs by virtue of holding shares in ....any other body corporate". The answer to (b) appears simple: the merger gave all Household's assets and liabilities to H2, a wholly owned subsidiary of HSBC. By virtue of its ownership of the shares of H2, HSBC controlled the affairs which had been the affairs of Household.

348.However, did Household exist after the moment of merger and does it matter if it  
35 did not? Whether Household ceased to exist at the moment of merger is a question of the law of the State of Delaware which is for this Tribunal a question of fact. It was an agreed fact between the parties that at the point of merger "the separate corporate existence" of Household ceased and H2 from that point onwards possessed the assets and liabilities of Household.

40 349.We take into account that (a) the word merger itself implies that the entities merged rather than ceased to exist; (b) under Delaware law (as agreed by the parties) only the separate legal existence of Household ceased, suggesting that Household's

legal existence had been subsumed into H2's legal existence rather than obliterated; (c) the fact both the assets *and liabilities* of Household became those of H2 suggests that Household had some (if subsumed) legal existence – it was not merely a transfer of assets.

5 350. In any event, the “affairs” of Company Y should probably be read to include the affairs of a former company: the reference to “affairs” by itself implies that the drafters were trying to embrace as many scenarios on a share for share or similar transaction as possible and did not intend s 95(4) to be construed narrowly.

10 351. So for both reasons, firstly that the affairs were still the affairs of Household, and secondly, if we are wrong on this and they were the affairs of H2 alone following the merger, then nevertheless they had been the affairs of Household up to the point of merger and on a proper reading of s 95 (4) they were caught by it. In conclusion, HSBC did obtain control of Household because HSBC had power to control the affairs which had been Household's affairs by virtue of its ownership of shares in and  
15 voting control over H2.

352. Was there an exchange of shares? As far as the Household stockholders were concerned, they gave up their Household share certificates and received in exchange HSBC shares or HSBC ADRs. However, the legal effect of the merger was the shares in Household were cancelled by operation of law on 28 March at the time of the  
20 merger. Neither H2 nor HSBC became a shareholder of Household.

353. S 95(3) refers to “an issue by a company (company X) of securities in exchange for shares in another company”. Whether this applies to the merger in front of us is, we think, ambiguous. Literally it was not a share for share exchange for HSBC: as far as HSBC was concerned the issue of the HSBC shares was in exchange for the  
25 affairs (the assets and liabilities) of Household rather than its shares (which were cancelled and never owned by H2 or HSBC); on the other hand, so far as the former Household stockholders were concerned they had to agree to give up their Household stocks in exchange for HSBC shares or ADRs. They exchanged the former for the latter. For them it was a share for share exchange.

30 354. What was the intention of the draftsman? At the time, merger (in this sense) was a concept unknown in English law and this provision was unlikely to have been intended to apply to such a merger. On the other hand there is no logical reason s 95 would have been intended to apply only to literal share for share exchanges rather than any transaction which had the practical effect of a share for share exchange and  
35 there are indications (the use of the word “affairs” and the alternatives in (3)(a) and (b)) that the draftsman intended to catch different types of transaction with the same result. As there is ambiguity we opt for the less literal interpretation. This interpretation is that the exemption applied to transactions where investors in the target gave up shares in return for shares in the acquirer whether or not the acquirer  
40 obtained in exchange the shares of the target or merely effective control of the affairs of the target. Such an interpretation is more likely to be consistent with the intention of Parliament at the time. On this basis, the merger was a share for share exchange and therefore as at 1994 it was exempt from SDRT. The grandfathering provisions do

not apply, and the SDRT charge would be unlawful under the Treaty were it not unlawful under the Directive.

### Reference to CJEU?

5 355. Although originally all parties were agreed that a reference to the CJEU would be necessary, a few weeks before the hearing it became HMRC's position that it is unnecessary for this Tribunal to make a reference to the CJEU. They consider it plain that the SDRT charges at issue in this appeal were lawful under EU law. The Appellants' position also changed so that by the end of the hearing they said the answers to the questions of EU law were clear and a reference was unnecessary, 10 although of course their view of the law was the opposite of HMRC's.

356. The Treaty on the Functioning of the European Union Article 267 provides:

“The Court of Justice of the European Union shall have jurisdiction to give preliminary rulings concerning:

- 15 (a) the interpretation of the Treaties;
- (b) the validity and interpretation of acts of the institutions, bodies, offices or agencies of the Union;

20 Where such a question is raised before any court or tribunal of a Member State, that court or tribunal may, if it considers that a decision on the question is necessary to enable it to give judgment, request the Court to give a ruling thereon.

Where any such question is raised in a case pending before a court or tribunal of a Member State against whose decisions there is no judicial remedy under national law, that court or tribunal shall bring the matter before the Court.”

25 357. We are not a court whose decision is final. Therefore we have a discretion to refer this case if a ruling from the CJEU is *necessary* for us to give our decision.

358. In *R v International Stock Exchange of the UK and Republic of Ireland Ltd ex parte Else (1982) Ltd & another* [1993] QB 534 Bingham LJ at page 545 said that:

30 “I understand the correct approach in principle of a national court (other than a final court of appeal) to be quite clear: if the facts have been found and the Community law issue is critical to the court's final decision, the appropriate course is ordinarily to refer the issue to the Court of Justice unless the national court can with complete confidence resolve the issue itself.... The national court must be fully mindful of the differences between national and Community legislation, of the pitfalls which face a national court venturing into what may be an unfamiliar field, of the need for uniform interpretation throughout the Community and of the great advantages enjoyed by the Court of Justice in construing Community instruments. If the national court has 35 any real doubt, it should ordinarily refer.”

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359. The question of when issues should be referred to the ECJ was also considered by the Court of Appeal in the case of *Customs & Excise Commissioners v Littlewoods Organisation plc* [2001] EWCA Civ 1542 in which Chadwick LJ said:

5 “(117-8) but it is we think, important to have in mind, also, the observations of Advocate General Jacobs in *Weiner SI GmbH v Hauptzollamt Emmerich* (Case-338/95) [1997] ECR I-6495. A measure of self-restraint is required on the part of the national courts, if the Court of Justice is not to become overwhelmed. A passage of his opinion is of particular relevance in the present context (see [1997] 10 ECR I-6495 at 6515-6516, para 61) –

‘...another development which is unquestionably significant is the emergence in recent years of a body of case-law developed by this court to which national courts and tribunals can resort in resolving new questions of Community law. Experience has shown that, in particular 15 in many technical fields, such as customs and value added tax, national courts and tribunals are able to extrapolate from the principles developed in this court’s case-law. Experience has shown that that case-law now provides sufficient guidance to enable national courts and tribunals – and in particular specialised courts and tribunals – to decide many cases for themselves without the need for a reference.’ 20

In our view this is not an appropriate case for a reference by this court. For the reasons which we have set out we are satisfied that there is ample guidance on the question of principle in the existing decisions of the Court of Justice. We feel confident that we can apply the principle 25 to the particular facts of the appeals which we have to decide.”

360. We therefore need to determine which side of the line this case falls: is it one where we cannot with complete confidence resolve the questions of EU law which arise? Or is it one where we can safely extrapolate from the principles developed in the CJEU’s case-law?

30 361. The CJEU has already given a number of decisions on Articles 10-12 of the Directive albeit all in slightly different factual circumstances than apply in this case. If we make another reference, will it be a failure to exercise self-restraint and a failure to apply principles which the CJEU has already made clear?

35 362. In this case we have already expressed our opinion in favour of the Appellants’ case. We have applied principles propounded by the CJEU in *Vidacos* and *Belgium*. We used those principles to decide what the CJEU meant by “integral”. In so far as whether the transfer from CTCNY to BNY Nominees was integral is a question of law we have applied principles propounded by the CJEU in those two cases; in so far as it is a question of fact it is solely within the jurisdiction of the national courts.

40 363. We have decided that as a matter of law because the transfer from CTCNY to BNY Nominees was integral to the raising of capital by HSBC the SDRT charge was within Articles 10 and 11 and not relieved by Article 12, and we have distinguished *Codan* and *Fortum* because the charge in those cases was not on any part of the *issue* of the securities agreed by the company raising the company to be given to the new

investors. We consider that that is consistent with the principles propounded in *Vidacos* and *Belgium*.

5 364. We have considered the territorial application of the Directive, and although there are no decisions of the CJEU to which our attention has been drawn, it seems plain to us that the Directive was intended to apply to *any* raising of capital by an EU registered company, such as HSBC.

10 365. If we are right on these three issues then none of the other issues put to us, such as the Treaty, arise. If we can confidently resolve these three issues then no questions need to be referred as the others become hypothetical. We are of the opinion that we can and we have therefore decided not to make a reference.

15 366. In summary, our view is that, although the overall transaction was more complicated in this case than in the earlier cases referred to the CJEU, nevertheless it was clearly within the principles propounded by the CJEU in *Vidacos* in that the SDRT was a charge on a transfer that was “an integral part of an overall transaction with regard to the raising of capital” and that further HSBC as an EU company raising capital was able to rely on the direct effect of the provision that rendered it unlawful.

367. The appeal is allowed.

### **Appeal rights**

20 368. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)”  
25 which accompanies and forms part of this decision notice.

**Barbara Mosedale**

30

**TRIBUNAL JUDGE**  
**RELEASE DATE: 28 February 2012**

Amended pursuant to rule 37 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009 on 21 March 2012.

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