

Sure of Shell

KEITH PARKHOUSE explains the advantages of an election to receive foreign scrip dividends.

Mike Thexton's article 'Scrip, DRIP, CRIP' (see *Taxation*, 7 July 2011, page 16) provided a useful reminder of the differing tax treatment of scrip dividends and dividend reinvestment plans (DRIPs) and applied those principles to three widely held shares that have used them in recent years: Standard Life, Rolls-Royce and Banco Santander. I have had a recent encounter with another widely held share, Royal Dutch Shell Group (RDS), which has been the subject of a revamped scrip dividend scheme in the past year, and which readers may find of interest.

A little history

A previous *Taxation* article by Richard Curtis ('Shelling out', *Taxation*, 21 July 2005, page 430), discussed the share history of the RDS, and I do not propose to repeat what was said therein. It will suffice to say that the result of the share reconstruction was a parallel share structure in which the former holders of Royal Dutch Petroleum acquired A shares in RDS, a Dutch resident company, and the former holders of Shell Transport and Trading plc acquired B shares in RDS. However, the B shareholders receive their dividends via a dividend access share that is held by Lloyds TSB Offshore Trust Company as trustee, and it is by this mechanism that RDS UK source income is streamed to the B shareholders, so that their dividends are effectively UK source income.

The scheme

This structure has been put to quite creative use in the scrip dividend scheme which was implemented by RDS towards the end of 2010. Under that scheme, holders of B shares may elect, no later than a specified date prior to the next dividend payment date (26 November 2010 for the first dividend under the scheme payable on 17 December 2010), to receive A shares in lieu of the

KEY POINTS

- The background to the present Royal Dutch Shell share structure.
- Converting Shell B shares into A shares.
- FRIPs and the negated income tax liability.
- Potential capital gains tax liability may be avoided.
- Confirming the location of the shares.



cash dividend. The first allocation of A shares was at the rate of one A share for every 79.61667 B shares. Only whole shares may be bought; any excess of dividend over the value of shares bought is therefore carried forward as a cash balance and made available for the next allocation of shares.

The income tax treatment

Ordinarily, the issue of UK shares would trigger an income tax charge on the cash equivalent of the dividend in accordance with the provisions now to be found in ITTOIA 2005, Part 4, Ch 5. However, ITTOIA 2005, s 410 limits the charge to share capital issued by a UK resident company. As we have seen above, RDS is a Dutch resident company, and this foreign scrip dividend (let's call it a FRIP, as it is easier to pronounce than FSCRIP) is therefore treated as a bonus issue of shares with no income tax liability attaching.

The A shares received will rank for dividends on subsequent payment dates, and the cash dividends will be received subject to Dutch withholding tax at the rate of 15%. The basic rate taxpayer will incur no further tax liability on the dividend, whereas the taxpayer liable at higher rates will only pay UK tax at the excess of the higher (or additional) dividend rate over the 15%

ADDITIONAL LIABILITY

	£
Gross equivalent of net £900 dividend	1,000
Income tax at the dividend additional rate of 42.5%	425
Less: Non-repayable tax credit	<u>(100)</u>
Additional liability	<u>325</u>

withholding rate.

To avoid this liability altogether a separate election needs to be made to receive scrip dividends (in the form of additional A shares) in place of the A share cash dividends and the tax treatment will then be the same as for the scrip dividends received on the B shares.

The capital gains tax treatment

TCGA 1992, s 142 ('Capital gains on stock dividends') states that where ITTOIA 2005, s 410 above applies and the share capital is issued to an individual, trustees or personal representative, then the share capital is treated as acquired for consideration equal to the cash equivalent of the share capital. But as we have seen, s 410 only applies to stock dividends from UK resident companies. In the absence of an income tax charge under the stock dividend rules there is no enhancement of the capital gains tax base cost, but part of the cost of the original holding is apportioned to the new shares using the well-known 'A over A plus B' formula. This apportionment will have to be done in respect of every dividend. The easiest way of doing the apportionment is of course to use the fractions published by the dividend information services.

The net result

The net result of using this scheme is that a series of income tax liabilities have been avoided at the expense of an equivalent amount of capital gains that are not charged to tax until the holding is disposed of. At current rates of tax the savings can be worthwhile. Consider Mr X, a 50% taxpayer who receives a scrip dividend of £900. He has avoided income tax as shown in **Additional liability**.

If we try to compare like with like, if Mr X in **Additional liability** were to sell his Shell shareholding on the day that the A shares are issued, the additional capital gains tax that he would potentially pay on the disposal would be £252 (i.e. 28% x £900, the amount by which the value of his shareholding would have increased on that date). This would give rise to a tax saving of £73 compared with the additional income tax liability. The saving would be more if the disposal was instead made in a later year when he may be a basic rate taxpayer, or when his gain could be fully used against his annual exempt amount. If the occasion of charge was his death there would be no capital gains tax at all. There might be an inheritance tax liability, but if the taxpayer had taken the dividends in cash and added them to his savings there would be inheritance tax on that too, so in this respect the tax question is neutral to the cash versus scrip decision.

Location of the shares

Non-UK domiciliaries holding RDS B shares and acquiring scrip dividends in the form of A shares might well wonder where their shareholdings are located for capital gains tax purposes. If their shares in what is, as previously explained, a Dutch resident company were to be treated as non-UK situs then capital gains on their realisation would not be chargeable to UK capital gains tax unless remitted to the UK.

The position is in fact quite straightforward. TCGA 1992, s 275 applies two rules to determine where the shares in a company are located:

- (1) shares in or debentures of a company incorporated in any part of the UK are situated in the UK; and
- (2) subject to 1 above, registered shares or debentures are situated where they are registered and, if registered in more than one register, where the principal register is situated.

The main share register for RDS, for both the A and the B shares, is in the UK, and is maintained by Equiniti. The question of them being foreign situs assets does not therefore arise. ■

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