Further written evidence submitted by the Chartered Institute of Taxation (FB09)

Substantial Shareholding Exemption (clauses 27 and 28)

Summary

This is a welcome set of changes which will enable a wider range of corporate groups to use the exemption.

The proposal

Following a consultation in summer 2016, these clauses amend the substantial shareholdings exemption (SSE). The SSE exempts from corporation tax gains or losses coming from the disposal by companies of shares where certain conditions are met. It was introduced in 2002. The Government state the aim of the SSE to be "eliminating the potential double taxation of trading profits in a company or sub-group being disposed of when these are realised by the shareholder by way of a disposal of their shareholding rather than, for example, by way of a dividend which would be exempted from tax in the hands of a corporate shareholder, and to facilitate the restructuring of groups without triggering a tax charge." (HMRC Policy Paper 'Reform of Substantial Shareholding Exemption for qualifying institutional investors', 5/12/16)

Clause 27 makes the exemption far more accessible to a wider range of corporate groups. Clause 28 introduces an exemption for shareholders in companies that have substantial investment by 'qualifying institutional investors'.

Timings

The changes were originally included in Finance (No 2) Bill in March, but dropped due to the early general election. However, the new rules will still apply for all disposals on or after 1 April 2017. This has obviously led to uncertainty for taxpayers, particularly in the period before the announcement on 13 July that these rules would apply from 1 April 2017. This demonstrates the inadvisability of making new legislation effective before it receives royal assent. However, hopefully this will be the last time this issue arises due to the move from this autumn to holding a single fiscal event (Budget) in the autumn. This will lead to a Finance Bill introduced in December and passed in the spring, hopefully before any measures come into force for the following tax year.

General relaxation of the exemption

For disposals on or after 1 April 2017, the condition that the company making the disposal must be a trading company or member of a trading group has been withdrawn. The condition that the company being sold must meet the trading condition immediately after the disposal has also been withdrawn (except where trading activities have been hived down to a new company which is then sold with the benefit of the SSE), provided the disposal is to an unconnected person. In addition, the exemption has been extended to disposals of shareholdings of less than 10%, provided at least 10% was held for a 12 month period within the six years up to the disposal (previously two years).

We welcome these changes. In particular, the withdrawal of the investor trading condition will remove many of the uncertainties arising under the existing rules. The existing rules can cause difficulties, for example, for UK subsidiaries which may not have full details of the worldwide group. It will also remove the challenges of applying the UK grouping test to non-UK entities and enable groups with mixed trading/investment activities to access the exemption for disposals of trading businesses.

The withdrawal of the post disposal trading condition for the company being sold is helpful as meeting this condition was not wholly within the control of the seller.

The extension of the look back period for disposals of small shareholdings of less than 10% will be helpful for investors disposing of interests in tranches, whilst limiting the availability of capital losses in such circumstances.

Qualifying Institutional Investors

The revised draft legislation published on 13 July dealing with the SSE only related to the proposed new exemption for investing companies owned by qualifying institutional investors, which has no trading requirement and allows the substantial shareholding requirement to be satisfied for investments of less than 10% but costing at least £20m.

The CIOT wrote to HMRC to raise concerns around the way in which the definition of a "substantial shareholding" would operate for qualifying institutional investors in circumstances where the shareholding is less than 10%, but cost more than £20m.

The test in new paragraph 8A(3) regarding the "proportionate percentage" was too strict and may cause the test to be failed in circumstances where the policy intention is that the exemption should be available. The problem arose from the words "….percentage <u>equal to</u> the percentage of ordinary share capital .." in new paragraph 8A(3). This drafting was very restrictive and would have meant that even a very small disparity between the percentage of the shareholding and the amounts available to equity holders would be sufficient to disqualify a sub-10% holding from relief. Thus, for example, the existence of even a small amount of convertible debentures issued by the company invested in could deny relief. This stringent test would have been a common difficulty with the application of new paragraph 8A, and meant that the policy intention would not have been fulfilled.

We are pleased to note that the Finance Bill 2017-19 published on 8 September 2017 addresses this concern. The provision includes a new sub-paragraph (5) in the new paragraph 8A, which will be inserted into TCGA 199 Schedule 7AC which permits "insignificant" discrepancies between percentages of the shareholding and the amounts available to equity holders. This seems to be a sensible result.

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