

Substantial Shareholding Exemption

3 April 2018

BACKGROUND

The substantial shareholding exemption rules broadly exempt from corporation tax the capital gain or capital loss arising on the disposal of a 10% or higher shareholding of ordinary share capital in a trading company.

The rules have been relaxed so the exemption will be available under wider circumstances with effect for disposals taking place after 1 April 2017.

The key change is that the company making the disposal (the investor company) is no longer required to be a trading company before and after the disposal. However the requirement for the company being disposed (the investee company) to be a trading company remains, unless the investment is disposed by an institutional investor (see end of note for further details on institutional investors).

There are specific criteria that need to be met. The key changes from the old rules (pre 1 April 2017) to the new rules (post 1 April 2017) are summarised in the table below:

| | Pre 1 April 2017 | Post 1 April 2017 | Comments |
|----------------------------|---|--|--|
| HOLDING PERIOD | At least a 10% shareholding to be held for at least 12 of the last 24 months. | At least a 10% shareholding to be held for at least 12 months of the last 6 years. | Extension of holding period allows more flexibility for selling shares in stages. |
| INVESTOR TRADING CONDITION | Trading company or a member of a trading group before and immediately after disposal. | No requirement. | Previously the analysis of whether a group was trading could be complex and so this relaxation is welcome. |

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|----------------------------|--|---|--|
| INVESTEE TRADING CONDITION | Trading company or holding company of a trading group before and immediately after disposal. | Trading company or holding company of a trading group at date of disposal but not after disposal. | The relaxation to remove the post disposal trading condition is welcome as this is often out of the control of the seller. Although this does not apply in some circumstances (see below). |
|----------------------------|--|---|--|

INVESTEE COMPANY TRADING CONDITION ANTI-AVOIDANCE

There are two main situations where the investee post-disposal trading condition is *not* removed:

DISPOSALS TO CONNECTED PARTIES

Where disposals are to companies under common control, or to an existing owner, then it is considered there is sufficient influence to control the trading status immediately after disposal and so this requirement remains.

TRADE TRANSFERRED INTO COMPANY WITHIN LAST 12 MONTHS

Where a trade is transferred into the company within 12 months of the disposal in order to meet the pre-disposal trading requirement, e.g a hive down, the trading position of the previous company will be considered as well as the trading status immediately after disposal.

TRADING REQUIREMENT

A company or group is considered to be trading if it carries on trading activities and does not have 'substantial' proportion of non-trading activities. Substantial is broadly considered to be 20% of total activities.

Some or all of the following factors are considered:

- Turnover
- Asset value
- Expenditure incurred or time spent by officers and employees

- The company's history

A balance of indicators approach is taken to arrive at a conclusion on the trading status of the company.

SUMMARY

The relaxation of the substantial shareholding requirements with effect from 1 April 2017 are welcome. In practice this is unlikely to make a large difference for the majority of disposals. The main impact will be for disposals by groups where there was a question over the trading status of the group, with this requirement now removed.

It will also be important to consider if a disposal is to a connected party, or if a trade has been transferred to the company within 12 months of disposal, as the investee condition is not relaxed in these circumstances.

INSTITUTIONAL INVESTORS

New rules have been introduced with effect from 1 April 2017 such that fewer qualifying conditions are required to obtain the substantial shareholding exemption for companies that are wholly or partly owned by certain institutional investors.

Qualifying entities include:

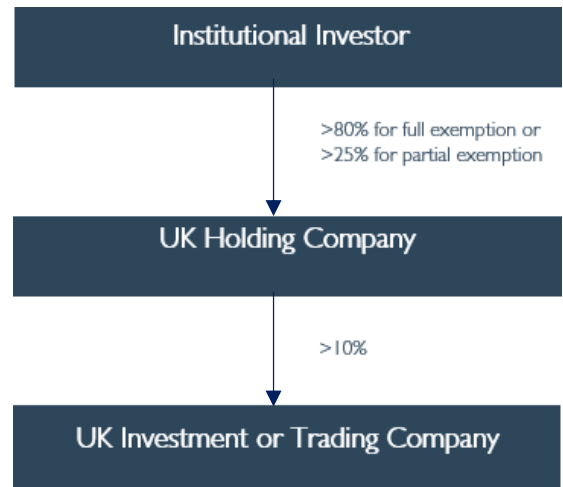
- Pensions schemes
- Life assurance businesses
- Sovereign wealth funds
- Charities
- Investment trusts
- Authorised investment trusts
- Exempt authorised unit trusts
- Qualifying UK REITs

The key relaxation compared to the general new substantial shareholding exemption rules is that the company being sold (the investee company) is not required to be trading before or after the disposal. The investor company is also not required to be trading before or after the disposal.

Full exemption is available where the institutional investors qualifying interest in the company making the disposal exceeds 80%. Partial exemption is available where the interest is between 25% and 80%.

There is also a relaxation of the 10% shareholding requirement where shares are acquired for more than £20million. The one qualification is that the rights as equity holder in respect of distributions and assets on winding up should match the proportionate shareholding.

TYPICAL INSTITUTIONAL INVESTOR STRUCTURE:



SUMMARY

This relaxation is welcome and should assist with the government's aim of increasing the competitiveness of the UK, as a location for a holding company. In particular this should increase the attractiveness of investment in IP companies and similar investment companies, which would not have previously received an exemption on disposal.

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