



## **Response from ICAS**

# **Reform of the Substantial Shareholdings Exemption: Consultation**

17 August 2016

## **About ICAS**

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

## **General comments**

2. ICAS welcomes the opportunity to contribute to "Reform of the Substantial Shareholdings Exemption: Consultation" issued by HMT on 26 May 2016.
3. The Substantial Shareholdings Exemption (SSE) was introduced in 2002 to enable trading groups to make rational business decisions on restructuring, reinvestment and the disposal of shares in trading companies without being discouraged by potential corporation tax liabilities. It also aimed to discourage groups from adopting complex offshore holding structures which reduce transparency and create unnecessary administrative burdens for businesses and HMRC.
4. For many UK trading groups SSE has broadly worked well. However, there are anomalies and areas of the SSE legislation which are ambiguous or produce outcomes that are inconsistent with the policy intention. These are discussed in paragraphs 21 to 28 below. The current SSE review provides an ideal opportunity to address these issues.
5. The consultation document outlines five main options for change: these are discussed in paragraphs 7 to 18 below. ICAS believes that a combination of Options 2, 3 and 4 would address many of the problems encountered by companies seeking to use the current regime and would help to ensure that the objectives of the SSE regime are met.
6. ICAS is supportive of extending SSE to the funds sector as proposed by the consultation document: this is discussed in paragraphs 19 to 20 below.

## **Option 1: Comprehensive exemption**

7. There could be a new, wide-ranging exemption for gains on substantial share disposals, with minimal requirements as to the nature or activities of the companies involved in the transaction. However, the consultation document identifies a number of concerns which would need to be addressed, so that the exemption would be confined as far as possible to gains derived from taxed income. It should also not create scope for the tax-free transfer of enveloped passive assets or create opportunities for individuals to hold assets through a corporate vehicle to defer tax on chargeable gains.
8. It seems likely that any comprehensive exemption of the type suggested by Option 1 would require so many anti-avoidance provisions to address the listed concerns that it would be very complicated and probably of limited usefulness. We therefore have no detailed comments on this option.

## **Option 2: Exemption subject to investee trading test**

9. New rules could retain the trading condition on the company or sub-group being disposed of, but remove the condition that the company making the disposal must be part of a trading group. This would significantly simplify the SSE and would reduce costs and save time, especially for global groups. Currently, in order to evaluate whether the conditions for SSE are met, these companies and their advisers have to spend time looking at entities which have no bearing on the UK activities but can determine whether a UK disposal is taxed or not. It would also make the exemption available whenever a trading company or sub-group is disposed of, even where the disposal is made by an investment company or a company within a substantially non-trading group.

10. Option 2 could potentially address the situation where a holding company disposes of its entire trading group and decides that the best course of action is to invest the proceeds in some other way, or return the funds to shareholders. Currently SSE would not be available, due to the investor restrictions, but this seems anomalous: there is no tax avoidance motive. Applying the test to the investee could resolve this problem.
11. Ideally Option 2 could be combined with elements of Option 3 and 4, as indicated in the flow chart in A "Illustrating the options".

### **Option 3: Exemption subject to investee test other than trading**

12. Changes could remove the requirement that the company making the disposal must be part of a trading group, while requiring the company or sub-group being disposed of to be either trading or actively conducting business activities other than trading. Acceptable non-trading business activities might perhaps include certain activities positively defined in legislation, and/or investment companies to the extent that there are significant associated management functions.
13. In refining the investee test it would be useful to include property development as an acceptable activity. This would make the UK more attractive to real estate businesses, particularly important because the REIT regime is not perceived to be as attractive as some regimes in other jurisdictions.
14. As noted in paragraph 11 above a combination of options 2, 3 and 4, as indicated in the flow chart in A, would be helpful and would address many of the problems encountered by companies seeking to use the current SSE regime.

### **Option 4: Amended trading tests at investee and investor level**

15. The SSE could be simplified by focusing the investing and investee trading tests on the companies involved in the transaction, rather than applying them at a group or sub-group level. This could also help ensure that the availability of the exemption relies on factors over which a UK company has more control.
16. As noted in paragraph 11 above a combination of options 2, 3 and 4, as indicated in the flow chart in A, would be helpful and would address many of the problems encountered by companies seeking to use the current SSE regime.

### **Option 5: Changing the definition of 'substantial shareholding'**

17. The definition of a substantial shareholding as at least 10% of a company's ordinary share capital could be amended by lowering the 10% threshold, perhaps qualified by a minimum invested capital requirement.
18. ICAS is not aware of any compelling reasons for lowering the substantial shareholding threshold or augmenting it with a minimum invested capital requirement.

### **SSE and the funds sector**

19. As the consultation document notes, SSE is frequently not available to sovereign-wealth funds and pension funds. The UK investor company test is likely to deny access to SSE for the investment fund due to substantial non-trading activities. The use of offshore holding company structures (with access to overseas participation exemptions) is attractive for exempt investors such as pension funds and sovereign wealth funds which would otherwise be in a worse position than if they had invested directly.
20. ICAS is supportive of extending SSE to the funds sector, as discussed in part 5 of the consultation document. This would make the UK a more attractive place for the funds sector and bring economic benefits to the UK. Through a targeted exemption for investment funds from the substantial non-trading activities condition, investment funds could use UK based holding platforms and still have access to SSE. As noted it would be necessary to target the exemption: a possible approach would be to adopt the definition of "collective investment scheme" as set out in s235 of Financial Services and Markets Act 2000. This should also enable transparent vehicles to be captured and brought within the scope of the exemption.

## **Areas of the SSE legislation which are ambiguous or produce outcomes that are inconsistent with the policy intention**

### **Ordinary share capital**

21. The SSE regime's focus on ordinary share capital in determining the members of a group can lead to anomalous results, for example, in the situation where companies are limited by guarantee. There can be good commercial reasons for the use of such a structure but under the current rules the sale of such a company would not be within SSE, even if the investee otherwise meets the trading tests. There can also be uncertainties with respect to shareholdings in overseas companies where the concept of ordinary share capital may not strictly follow the UK concept. This could be addressed by reference to an equity interest rather than ordinary share capital.

### **Trade/assets previously owned by another group company**

22. Para 2.12 of the consultation document notes that the SSE legislation was amended in Finance Act 2011: "the period over which a parent is treated as holding shares in a subsidiary for the purposes of the SSE was extended where that subsidiary's trade/assets were previously owned by another group company. This allow groups to put trading activities into a newly incorporated subsidiary and then sell that subsidiary without share disposal gains being subject to corporation tax." This was a welcome improvement to the SSE regime. However, it has subsequently emerged that there is a problem in the way HMRC interpret the legislation.
23. The 2011 amendment was originally intended to allow a singleton company carrying on several trades in divisions, rather than using separate subsidiaries for each trade, to take advantage of SSE. These companies were at a disadvantage compared to companies which had a separate trading subsidiary for each trade. However, HMRC interpret the legislation as requiring that the company must have been a group member before the transfer so a singleton company still cannot qualify. HMRC's Capital Gains Manual specifically states (CG53080C): *"Note that paragraph 15A extends the holding period by reference to the previous use of trading assets by a member of the group while it was a member of a group. Therefore a capital gains group must have existed at the time. The provision cannot apply where the transferee company is a newly acquired subsidiary of what was previously a single trading company."*
24. As a result of this approach, singleton companies are still at a disadvantage. Clearly a well-advised company, planning ahead, can address this problem by incorporating a subsidiary for the sole purpose of creating a group – before creating another subsidiary to implement the sale using the FA 2011 rules. However, there is no good reason for this to be required and it simply creates a completely unnecessary complication and administrative burden. This cannot be consistent with the policy intention and the current review of SSE would be an ideal opportunity to address the point by amending the legislation to make clear that the only interpretation is one that would allow singleton companies to benefit, as originally intended.

### **De-grouping charges**

25. Paragraph 2.13 of the consultation document notes that FA 2011 also changed the rules on de-grouping charges (which arise when an asset is transferred on a no gain/no loss basis to a company that is then sold within 6 years). The change was to treat these de-grouping charges as additional consideration for the disposal in the hands of the seller. This means that the de-grouping charge is effectively extinguished where the disposal qualifies for the SSE. Again this was a welcome improvement to the SSE regime.
26. Unfortunately, the FA 2011 amendment was not extended to the intangible assets regime, in spite of the fact that this is closely modelled on the capital gains de-grouping rules. This significantly restricts the usefulness of the FA 2011 change to SSE de-grouping charges and therefore does not support the SSE policy intention of enabling trading groups to make rational business decisions on restructuring, reinvestment and the disposal of shares in trading companies without being discouraged by potential corporation tax liabilities. Again the current review of SSE would be an ideal opportunity to correct this anomaly.

## **Qualifying period**

27. For a company to benefit from SSE on a disposal of shares in another company, it must have held a 10% shareholding in that company for a 12 month period in the 2 years prior to the disposal. As the consultation document notes, in some cases share disposals may fail to qualify for SSE as a result of the sale of the residual shareholding in a company being delayed by circumstances outside the vendor company's control.
28. Paragraph 6.14 of the consultation document proposes to address this by extending the period over which the 10% shareholding requirement can be satisfied to 6 years, in line with the period of consideration under the de-grouping rules. This seems a sensible proposal and would also address the problem noted in paragraph 6.15 by limiting opportunities for groups to bring disposals made at a loss outside SSE by artificially delaying the sale of a rump shareholding.