

Share for share exchanges – how they work for tax

(Lecture B1053 – 8.43 minutes)

Elton and Kiki own Heart Ltd equally. They have decided that they want to create an intermediate holding company to own Heart Ltd. To achieve this, Elton and Kiki sell their shares in Heart Ltd to a new intermediate holding company in exchange for shares in the holding company issued by that company. Elton and Kiki now own 50% each of the intermediate holding company.

Capital gains tax position

Elton and Kiki have disposed of their shares in Heart Ltd and normally we would expect a chargeable gain to arise. However, provided the share for share exchange is for bona fide commercial reasons, the transaction falls within s135 TCGA 1992 and share for share exchange relief is available. Under s135 TCGA 1992 no disposal occurs for capital gains tax purposes but instead the new shares acquired in the intermediate holding company are deemed to have been acquired for the same amount and at the same time as the original holding in Heart Ltd. This is sometimes referred to as the 'step into the shoes' rule. Thus a gain will only crystallise when the new shares are disposed of at some point in the future.

It is important that HMRC agree that the transaction is for bona fide commercial reasons and so taxpayers should seek clearance from HMRC in advance of the share for share exchange (s138 TCGA 1992).

Stamp duty

The intermediate holding company will have acquired shares in Heart Ltd. Under normal circumstances stamp duty would be payable at a rate of ½%.

However, provided that the proportions of the shareholdings of the original company and the proportions in which they are owned in the new company are mirrored, then s77 FA86 relief applies. This relief must be applied for and, to be successful, certain conditions must be satisfied. The main condition is that the share for share exchange must be carried out for commercial reasons and not for tax avoidance purposes.

With Elton and Kiki originally owning 50% each in Heart Ltd and now owning 50% each in the intermediate holding company, the mirror image shareholding requirement has been satisfied and relief is available and no stamp duty is payable.

Taxpayers should be aware that S77A FA 1986 blocks the stamp duty relief if, at the time of the share for share exchange, there are arrangements in place whereby a change in control in the acquiring company is possible. (See the article that follows on capital reduction demergers)

Created from a lecture by Peter Rayney