

Substantial shareholding exemption case (Lecture B1258 – 10.48 minutes)

SSE requirements

The substantial shareholdings exemption (SSE) legislation (TCGA 1992, Sch 7AC) broadly provides that a gain on the disposal by a company of shares (or an interest in shares, or certain assets related to shares) will not normally be a chargeable gain, provided two conditions are met:

1. The company making the disposal (the 'investing company') must have held a 'substantial shareholding' in the company whose shares are being disposed of ('the company invested in' but commonly known as the 'investee company');
2. Certain requirements must be met in relation to the investee company, which largely involve the company being a trading company or the holding company of a trading group or a trading subgroup for a specified 12-month period prior to the disposal (and in some cases immediately after the disposal as well).

There is an exception from the second condition for qualifying institutional investors. There are also circumstances where the SSE does not apply, such as where arrangements were made with a sole or main benefit of ensuring that a gain on disposal is covered by the SSE (Sch 7AC, para 5). In addition, there are exclusions from SSE such as for no gain, no loss disposals (Sch 7AC, para 6).

Substantial shareholding requirement

The 'substantial shareholding requirement' is that the investing company must have held a substantial shareholding in the investee company throughout a 12-month period beginning not more than six years before the day of the disposal (NB this six-year period was increased from two years in Finance (No. 2) Act 2017).

A 'substantial shareholding' broadly means that the investing company must hold at least 10% of the investee company's ordinary share capital and be entitled to at least 10% of the profits and assets available for distribution to equity holders by the investee company (NB there is an exception to this requirement for disposals of shares by companies who are themselves owned by qualifying institutional investors where certain conditions are met).

Intra-group transfers

There is an important relaxation in this 12-month ownership rule (in TCGA 1992, Sch 7AC, para 15A) in group situations. If certain conditions are met, the minimum 12-month substantial shareholding requirement is treated as having been met for the period that assets were used for a trade conducted by another group company before being transferred to the investee company.

There are four general conditions for this treatment to apply (in TCGA 1992, Sch 7AC, para 15A(2)). These are paraphrased below:

1. Immediately before the disposal, the investing company holds a substantial shareholding in the investee company;
2. At the time of the disposal the asset was being used for the purposes of a trade carried on by the investee company;

3. At the time of the transfer of the asset to the investee company by the investing company (or any other company), they were all members of the same group;
4. The asset must previously have been used by a member of the group (other than the investee company) for the purposes of a trade carried on by that member when it was a member of the group.

If the conditions are met, the effect of the investing company being treated as having held the substantial shareholding at any time during the final 12-month period ending with the time of disposal is that it can include a period before the company invested in existed.

SSE not available

In *M Group Holdings Ltd v Revenue and Customs* [2021] UKFTT 69 (TC), the appellant company ('MGH') traded as a standalone company prior to 29 June 2015. In 2015, the company's owner started to receive interest from potential buyers of the business and sought professional advice.

Subsequently, on 29 June 2015 MGH incorporated a company ('MCS') as its wholly-owned subsidiary. On 30 July 2015, MGH acquired the entire issued share capital of another company ('M5A'). On 30 September 2015, MGH hived down its trade and assets to MCS. On 28 October 2015, M5A commenced trading. On 27 May 2016, MGH sold the entire issued share capital of MCS to a third-party purchaser. The events all took place in 10 months and 28 days.

HMRC disallowed MGH's SSE claim in respect of the chargeable gain arising on the share disposal, and MGH appealed. The issue for the First-tier Tribunal (FTT) to decide was whether SSE was available despite MGH having owned the shares in MCS for less than 12 months and where there had not been a group of companies in existence for the 12 months prior to the share sale. This turned on the correct construction of TCGA Sch 7AC, para 15A(3), which treats an investing company as having held a substantial shareholding at any time during the final 12-month period when the asset was used by another group member for the purposes of its trade.

The FTT considered relevant case law principles of statutory construction, and how TCGA 1992, Sch 7AC, para 15A(3) should be construed. The FTT also reviewed extra-statutory and other materials. However, the FTT was unable to determine from the wording of the legislation anything which pointed either way on the issue in the appeal of whether the purpose of the legislation included providing relief for standalone trading companies acquiring and selling subsidiaries within 12 months.

The FTT found that HMRC's interpretation of TCGA 1992, Sch 7AC, para 15A(3) did not amount to a wholly unreasonable result sufficient to justify a "strained interpretation". The FTT concluded that paragraph 15A only extended the period of ownership for the purposes of paragraph 7 during such time as the relevant asset was used by another company (i.e. MGH in this case) whilst it was a member of the same group. MGH's appeal was dismissed.

Where are we now?

Subject to any appeal, the position according to the FTT is that the SSE provision in Sch 7AC para 15A cannot apply where the transferee company is a newly-acquired subsidiary of what was previously a standalone trading company.

On that basis, it would be prudent to ensure that where a standalone trading company is likely to dispose of a trade at some point in the future, consideration should be given to creating a subsidiary at least 12 months in advance to enable a hive-down in advance of a disposal of the subsidiary's shares, if possible.

Contributed by Mark McLaughlin