Group precedents

Large Corporate | OMB

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Emily Morris considers the interaction of the substantial shareholding exemption and the reorganisation provisions

Key Points

What is the issue?

Care should be taken when planning transactions to ensure that the intended relief is achieved

What does it mean for me?

While the substantial shareholding exemption (SSE) may apply to a transaction, other provisions may take precedent

What can I take away?

The nil gain/nil loss and share reorganisation provisions take precedent over SSE

When considering the corporate tax implications of disposing of shares in a subsidiary, a variety of provisions must be considered. All legislative references below relate to TCGA 1992, unless otherwise stated.

A disposal of shares to a third party for cash consideration will give rise to a chargeable gain or loss. This gain or loss is calculated by deducting the indexed base and the incidental costs of acquisition and/or disposal from the cash consideration received. A gain is chargeable on the company making the disposal, and usually in the year of the disposal. A capital loss arising on such a disposal may be offset against current period capital gains, or can be carried forward to be used against any future period capital gains.

Further relief may be available if the company making the disposal is part of a capital gains group. A capital gains group exists where a company has a 75% direct (and 51% indirect) ownership of the ordinary share capital of its subsidiaries. Under s 171A, an election may be claimed to transfer a current period capital gain or loss to another group company, to offset against any capital losses (including brought forward losses) or gains arising in that company.

SSE conditions

A chargeable gain or loss arising on the disposal of shares is exempt if the conditions are met for the substantial shareholding exemption (SSE). These

conditions are outlined in further detail in Sch 7AC. The SSE applies where the investing company, which must be a trading company or a member of a trading group, has held a minimum 10% interest in the company that it is disposing of, which must also be a trading company or the holding company of a trading group; and the investing company must have held this interest for a continuous 12-month period within the past two years.

A substantial amount of work may be required to determine whether a disposal qualifies for the SSE, as determining the trading status of a company and the group can be difficult. For these purposes:

- a trading company is defined as a company carrying on trading activities whose activities do not include, to a substantial extent, activities other than trading activities; and
- a trading group is defined as a group where the combined activities of the members when taken together do not include, to a substantial extent, activities other than trading activities.

The word ‘substantial’ is not defined within the legislation, although guidance from HMRC indicates that ‘more than 20%’ would be considered to be substantial. HMRC would look at the turnover of the group and companies, the net assets on the balance sheet and the amount of directors’ time spent on non-trading activities.

The shareholdings of investing companies within a capital gains group (as defined above) can be aggregated to meet the minimum 10% holding interest required.

If the SSE conditions are met, the whole gain or loss arising on the disposal would be exempt from tax.

Intra-group transactions

The exemption often applies to scenarios where a company (company A) disposes of its shareholding in another company (company B) to a third-party company (company C) for cash consideration.

However, we need to consider how the SSE would apply to intra-group transactions. In this situation, company A, which owns 100% of the ordinary share capital of company B and company C, disposes of company B to company C for a cash

consideration.

The answer to this question can be found within s 171. These provisions treat the transfer of assets between members of the same group as a nil gain/nil loss transfer, meaning that no chargeable gain or loss would arise on intra-group transfers. The base cost of the company acquiring the asset would be the indexed historic base cost of the asset. For example, company C would acquire the shares in company B at the indexed historic base cost. While the SSE may have applied to this disposal, the intra-group transfer provisions contained within s 171 take precedent.

Share reorganisations

We have dealt above with the interaction of the capital gains rules in relation to disposals where a cash consideration is received. Thought must also be given to disposals where all or part of the consideration received is shares or a loan note. Section 127 provides that where shares are exchanged for other shares or loan notes, a no disposal fiction is invoked; this means that the base cost of the old shares becomes the base cost of the new shares or loan note.

For example, company A disposes of shares in company B to company C, in consideration for shares within company C. In this example, company A would not be treated as making a disposal of the company B shares. Instead, the new company C shares acquired would stand in the shoes of the company B shares and would take on the historic base cost and acquisition date of the company B shares. Company C would acquire the shares within company B for their market value at the date of the disposal.

However, in such a transfer, it is also likely that the SSE would have applied to the disposal of the company B shares. Although not explicitly clear within the legislation, Sch 7AC para 4 provides that within such reorganisations we are required to notionally disapply the no disposal fiction provision and assess whether the SSE would have applied to such a transaction. If the SSE would apply to such a transaction, the reorganisation provisions are overridden. The disposal of the company B shares would therefore qualify for SSE. Company A would acquire the shares within company C for their current market value.

However, for share reorganisations that occur within a capital gains group, while Sch 7AC para 4 requires us to disapply the no disposal fiction to consider whether there would be a chargeable disposal on which SSE could apply, we have already seen

above that s 171 overrides the SSE provisions. As such, the SSE provisions are overridden, and the normal share reorganisation provisions contained within s 135 are applied.