

New Corporation Tax Relief for Substantial Shareholdings

INTRODUCTION

Finance Act 2002 introduced a new exemption for trading companies in respect of chargeable gains arising on the disposal of substantial shareholdings in other trading companies. Please note that this relief does not apply to unincorporated trading vehicles such as sole traders or partnerships. The relief applies for disposals on or after 1 April 2002. A substantial shareholding is one which amounts to more than 10% and which has been held for at least a continuous twelve month period during the two years immediately preceding the disposal.

Where the exemption applies, any gain on the disposal of shares is not chargeable to tax and any loss is not available to set against gains.

No claim is required. The exemption applies automatically provided the conditions are satisfied.

DETAIL

The new legislation is detailed in Schedule 7AC TCGA 1992.

A gain accruing to a company on the disposal of shares or an interest in shares in a company is exempt if the requirements of the schedule are met in relation to the shareholding, the company making the disposal and the company whose shares are being disposed.

Shareholding:

The company disposing of the shares must have held a substantial shareholding in the other company throughout a continuous twelve-month period during the two years immediately preceding the disposal.

The shareholding is substantial if the company disposing of the shares holds at least 10% of the ordinary share capital of the other company. The shareholding must also carry an entitlement to at least 10% of the profits available for distribution and the assets available on a winding up.

Where the company's shareholding has been at least 10% throughout its period of ownership, then there is no problem. However, the position becomes more complicated if the level of the shareholding has fluctuated.

EXAMPLE 1

On 1 April 2001, 'A' Limited purchases 15% of the ordinary share capital in B Limited. On 31 December 2001, 'A' Limited disposes of 7% of its shares leaving a holding of 8%.

The holding is increased to 12% by a further acquisition on 28 February 2002. 'A' Limited disposes of its complete share holding on 1 November 2002.

In this case the exemption is not available as there has not been a continuous twelve-month period when the holding was in excess of 10%.

EXAMPLE 2

On 1 March 2001, ABC Limited acquires 15% of the ordinary share capital of XYZ Limited. This shareholding is disposed of in full on 1 July 2002.

On 1 October 2002, ABC Limited re-acquires a 7% holding in XYZ Limited, which is held until its disposal on 1 April 2003.

The July 2002 disposal will qualify for the exemption because a substantial shareholding as been held for a continuous period of more than twelve months.

The April 2003 disposal also qualifies. This is because a substantial shareholding has been held for a continuous period of more than twelve months in the two years immediately preceding the disposal (1 April 2001 to 1 July 2002).

If the company making the disposal is a member of a group, it is treated as holding any shares, or any interest in shares, held by any other member of the group. Therefore a group member with a shareholding of only 5% could qualify for the exemption if other group members have a combined holding of 10% or more over a consecutive twelve month period falling within two years preceding the disposal.

Qualifying companies:

Both the company making the disposal and the company whose shares are being disposed of must be a sole trading company or a member of a qualifying group from the beginning of the continuous twelve-month period to the date of disposal and immediately after the time of the disposal. A qualifying group is a trading group. This also includes groups with not for profit activities which would be trading if those activities were ignored.

A trading company is a company which is carrying on trading activities. Trading activities are defined as follows: -

- a) carrying on a current trade;
- b) preparing to carry on a future trade;
- c) activities with a view to acquiring or starting a future trade;
- d) activities with a view to acquiring a "significant interest" in the share capital of another company that is a trading company or the holding company of a trading group or sub group.

EXAMPLE 3

A group consists a holding company with a trading subsidiary. This qualifies as a trading group by virtue of the subsidiary's trading activities. The holding company makes a disposal of its entire shareholding in the subsidiary company.

The exemption will not apply in this case as the company making the disposal will not be a trading company or member of a trading group immediately after the disposal. It is possible that the exemption may be available should the company use the cash received to invest in another trade.

Further exemptions:

There are two further special exemptions that are detailed in paragraphs 2 and 3 of Schedule 7AC TCGA 1992.

- a) if a gain arises on the disposal of options over shares, securities with rights attaching to shares or similar assets.
- b) if a gain arises which does not qualify but would have qualified if the disposal had taken place up to two years earlier.

Both of these exemptions are subject to other conditions being satisfied.

Anti-avoidance

There are anti-avoidance provisions to prevent the exemption being available in certain circumstances. These include measures to prevent companies turning a non-allowable loss into an allowable loss and trying to dispose of assets from a group under the cover of the exemption.

EXAMPLE 4

A group of companies includes a subsidiary that is a property holding company and the properties if disposed of would give rise to a capital gain. Trading activities are transferred to the property subsidiary in order that it meets the requirements of a qualifying company for the purposes of the exemption. The property subsidiary is then sold. Without the anti-avoidance provisions the gain on the properties would escape the charge to tax under the cover of the substantial shareholdings exemption.

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