

Business Helpsheet

Substantial shareholding exemption

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The substantial shareholding exemption permits UK trading companies to dispose of “substantial shareholdings” owned by them in other trading companies free of UK corporation tax on any realised gains. This is a powerful relief for corporate groups which, with careful forward planning, can result in some significant tax savings and maintain shareholder value.

1. Who does the exemption apply to?

The relief applies to corporate entities who are subject to UK corporation tax on their profits. It does not apply to unincorporated businesses such as sole-traders or partnerships.

2. What is the nature of the exemption?

Where certain detailed criteria are met, corporate entities can make disposals of shareholdings in other corporate entities without the resulting gain or loss being brought within the charge to UK tax. This means that there is no tax on gains, and losses are not allowable.

The relief also applies to an interest in shares or certain assets related to shares such as options.

3. What criteria need to be met in order to obtain the exemption?

The qualifying criteria are detailed and complex. In broad terms there are conditions to be met in connection with the following:

- Substantial shareholding
- Minimum holding period
- The investing company (“investing”)
- The target company (“target”)
- Trading activities

Substantial shareholding

The investing company must hold not less than 10% of the target company’s ordinary share capital and needs to be beneficially entitled to not less than 10% of the profits available to equity holders and 10% of the assets available to equity holders on a winding up of the company.

Where the target company is not a UK company these criteria require more careful consideration.

Minimum holding period

The investing company must have held a substantial shareholding throughout a continuous 12-month period beginning not more than two years before the disposal takes place.

Where the shareholding fluctuates within the two-year period before a disposal, careful consideration needs to be given as to whether the disposal qualifies.

The investing company

The investing company must either be a sole trading company or a holding company of a qualifying trading group. A qualifying trading group is a principal company, together with its 51% subsidiaries, that meets the qualifying trading conditions. The conditions must be met throughout the minimum holding period and up to the point of disposal.

The investing company must also meet the trading conditions immediately following the disposal.

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The target company

The target company must either be a trading company or the holding company of a trading group or sub-group. The conditions must be met throughout the minimum holding period and up to the point of disposal.

The target company must also meet the trading conditions immediately following the disposal.

Trading activities

A trading company's activities must not include to a substantial extent activities other than trading activities. Where a group exists, the definition applies to the activities of the group taken together.

HM Revenue & Customs consider that "substantial extent" means 20% or more of the company's activities. This can be measured in relation to the company's assets, its income or its expenditure in terms of time spent on non-trading activities.

4. What are the potential benefits?

The following example demonstrates how the Substantial Shareholding Exemption can provide significant practical benefits.

You own a Company (A) which has two trading activities. It is possible that you may find a buyer for one of the trades but may wish to retain the other trade.

By forming two new subsidiaries (B and C) and transferring one trade to each, Company A becomes the holding company of a trading group.

As long as all of the conditions for the exemption apply, it would be possible to sell either Company B or Company C free of corporation tax on any gain made. The other company can be retained.

If the trades were not separated in this way and Company A sold the trade and assets of one of its two trades for £2million, say, the company could potentially suffer corporation tax of up to £560,000 on the sale. Prior action could therefore save the group this much tax and leave more profit available to distribute to the shareholders.

5. How Menzies can help

The substantial shareholding exemption is a powerful relief which can provide significant tax savings where the conditions are met. In order to assist in securing these tax benefits we can:

- Review existing corporate group structures at an early stage with a view to advising on potential improvements to secure the exemption in the future.
- Assess the status of potential corporate disposals against the qualifying criteria
- Seek clearance from HM Revenue & Customs where there is doubt as to whether the qualifying criteria are met. This is particularly important when large amounts of tax are at stake.
- Assist in planning the timing of corporate disposals to ensure that the maximum tax benefits are obtained.
- Incorporate the transactions into the relevant corporation tax returns and defend the position with HM Revenue & Customs if required.

This is a detailed and complex area of the tax legislation and this guide is a summary only. Professional advice should be sought from your Menzies contact before taking any action.