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THE FUTURE OF THE SSE

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Two fundamental changes are being made to the substantial shareholding exemption (SSE) with effect from April 2017:

- **Investment companies – not just trading groups – will be able to benefit from SSE on the disposal of a 10%+ stake in a trading company.**

- **Companies that are at least 25% owned by qualifying institutional investors will be eligible for exemption (or partial exemption) on the disposal of any substantial shareholding irrespective of whether the underlying company is trading.**

In addition, some more minor relaxations are being made to the other conditions contained in the SSE legislation.

The changes were announced at the Autumn Statement on 23 November 2016 and draft legislation was published on 5 December 2016.

DISPOSALS BY INVESTMENT COMPANIES

Since the SSE was introduced in 2002, investment companies have in practice largely been excluded from the benefit of SSE. That is not least because the conditions for relief require that the company making the disposal must be a trading company or a member of a trading group immediately after the disposal takes place (Sched 7AC para 18(1)(b) TCGA 1992). For a group that has just disposed of its main trading subsidiary, that condition may well not be met. HMRC take the view that the group's remaining activities must be at least 80% trading in nature for the relief to apply.

The failure to meet the condition in para 18(1)(b) can be cured, but only by taking the rather drastic step of winding up the company that has just made the disposal as soon as reasonably practicable thereafter. That is generally accepted to be the effect of para 3(3) in Sched 7AC – although the actual statutory wording is somewhat obscure.

Now that the government has accepted, following a formal consultation, that this condition should be relaxed, the proposed legislative solution is admirably simple: the two paragraphs highlighted here (para 18 and para 3(3)) will be repealed.

This change goes beyond the issue identified above, because the company or group making the disposal will – from April 2017 – no longer need to be one whose activities are predominately trading activities either before or after the disposal. To take an extreme example, a group whose activities are 100% investment activities but which owns a 10% stake in a trading company could benefit from SSE on a sale of that portfolio holding.

FURTHER RELAXATIONS

The draft legislation includes two further relaxations to the existing SSE conditions which could prove useful in practice. First, the12-month minimum holding period for which a 10%+ shareholding must be maintained can be satisfied by looking back up to six years, rather than the current two year period. A group could therefore make an exempt disposal of shares up to five years after its interest in the company invested in falls below 10%. Of course, this potentially cuts both ways because a loss realised in these circumstances would not be allowable (since the SSE exempts losses as well as gains).

Secondly, the requirement that the company invested in must be a trading company or the holding company of a trading (sub) group immediately after the disposal will now apply only in cases where the disposal is to a person connected with the seller. The rationale for that change is that the post-disposal trading status of the company which has been disposed of is generally outside the control of the seller.

NEW EXEMPTION: OWNERSHIP BY QUALIFYING INSTITUTIONAL INVESTORS

In a conceptual departure from the existing SSE rules, a new type of exemption will be available on the disposal of shares in a company where:

- that company is not a trading company or the holding company of a trading (sub)group; and/or

- the shareholding in question does *not* constitute at least 10% of the company's ordinary share capital (provided that the cost of that shareholding on acquisition was at least £50m),

but in both cases only if the company making the disposal is owned by qualifying institutional investors.

This will operate on a sliding scale, so that 80%+ ownership by qualifying institutional investors will afford the disposing company full relief, with proportionate relief available where between 25% and 80% of the ordinary share capital is held by qualifying institutional investors. Ownership can be direct or indirect, although (in broad terms) it cannot be traced through listed companies.

Institutional shareholders that qualify for this purpose are those listed in the proposed new para 3A(9) of Sched 7AC TCGA 1992, being various types of vehicles that would not be subject to capital gains tax on disposals that they make directly: pension schemes, companies carrying on certain life assurance business, sovereign wealth funds, charities, investment trusts and widely marketed UK investment schemes.

A WELCOME DEVELOPMENT

These changes represent both a simplification of the existing SSE rules and an expansion to the scope of the UK's participation exemption for chargeable gains. Both are to be welcomed.

By relaxing some of the conditions for relief, the new legislation will remove a number of traps for the unwary that have often made the SSE tricky to operate in practice and that can lead to illogical results. In particular, removing the requirements in relation to the trading status of the company making the disposal is likely to be a helpful simplification for many businesses.

In addition, the new exemption for companies that are owned by qualifying institutional investors is likely to remove one of the barriers that might otherwise deter tax-exempt investors from investing through a UK holding company. It is worth pausing to note that this new exemption is surprisingly broad in scope, with almost no restrictions on the type of company or gain that can qualify. It is also an unusual example of the tax treatment of a company depending on the characteristics of its shareholders, rather than those of the company itself. Accordingly, for some companies eligibility for the new exemption is likely to vary from time to time as the composition of their shareholder base changes. This is not least because the proportionate ownership by qualifying institutional investors is tested immediately before the disposal rather than over the 12-month minimum holding period for the shares that are to be disposed of.

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