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# BriefingNote

## Substantial Shareholdings Exemption

**The Substantial Shareholdings Provisions exempt from UK tax any gains, and disallow relief for any losses, realised by trading companies and groups on the disposal of qualifying substantial shareholdings in other trading companies.**

The legislation applies automatically if certain detailed conditions are satisfied subject to anti-avoidance provisions which are designed to prevent the legislation being applied solely to obtain a tax advantage.

It does not cover gains or losses on shares held on trading account or on securities held under the loan relationships or derivatives provisions.

The exemption was originally introduced (in 2002) to bring the UK on to a more even footing with other European tax regimes.

**The legislation applies where the provisions are met with relation to:**

- The shareholding in the target company.
- The holding and target companies.

### Shareholding in the target company

For the legislation to apply, the holding company must have held a "substantial shareholding" in the target company for a continuous 12 month period within the two years ending with the date of disposal.

For these purposes, a "substantial shareholding" is defined as one of not less than 10% of the ordinary share capital, which carries an entitlement to not less than 10% of the profits available for distribution and the assets available for distribution on a winding up.

One point to watch is that the existence of a substantial loan held by a third party could jeopardise the requirement for entitlement to not less than 10% of the assets on a winding up. It is, therefore, necessary to review the position in detail before making any disposal of the shares.

### The holding and target companies

The main provision with relation to the holding company is that it must be either a trading company or a member of a trading group both throughout the 12 month period of ownership referred to above and immediately after the time of the disposal.

The condition for the target company is broadly the same. It has to be a trading company, or a member of a trading group, throughout the 12 month ownership period referred to above and, again, immediately after the disposal.

A trading company is defined as one where the company is trading and its activities do not include, to any substantial extent, activities other than trading activities. The same definition applies, broadly, to a trading group.

The term "substantial" is not defined in the legislation, but HM Revenue & Custom's guidance states substantial means more than 20%. The same guidance states that some or all of the indicators that might be taken into account in reviewing trading status could include:

- The level of turnover received from non-trading activities.
- The value of non-trading assets in relation to the value of all assets.
- The expenditure incurred or time spent by officers and employees on non-trading activities.
- The company's history.

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It is necessary, though, to bear in mind that the indicators are not individual definitive tests to which a 20% limit applies. The overall status of the company or group has to be considered in the round.

If there is any uncertainty about the position it may be possible to obtain clearance from HM Revenue & Customs that the exemption would apply.

## Additional exemptions

In addition to the main exemption outlined above there are two further exemptions (referred to in the law as subsidiary exemptions).

The first exemption provides relief for gains, or restricts relief for losses, on disposals of "assets related to shares". Such assets would include options and convertible debt. The relief applies where the investing company (or another member of its group) also holds shares in the target company and a gain or loss on the disposal of such shares would itself be exempt under the terms of the main exemption.

The other exemption relates to the disposal of both shares and related assets where the main exemption conditions are not met at the time of the disposal, but where, broadly, a disposal within the previous two years would have qualified for the main exemption.

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