REFORM OF THE SUBSTANTIAL SHAREHOLDINGS EXEMPTION

ICAEW welcomes the opportunity to comment on the consultation Reform of the Substantial Shareholdings Exemption published by HM Treasury on 26 May 2016.

This response of 16 August 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

Contents

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com/taxfac

T +44 (0)20 7920 8646
F +44 (0)20 7920 0547
E taxfac@icaew.com

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 146,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

icaew.com

GENERAL COMMENTS

1. We welcome the fact that the current consultation aims to align the SSE regime with the current international tax landscape and to eliminate complexities within the existing regime and make it part of a competitive UK tax environment.

2. We believe that a key aim should be to make the revised UK regime competitive with other European tax regimes which favour holding companies, such as the regimes of Luxembourg and the Netherlands. This objective takes on even greater importance in the aftermath of the EU Referendum vote of 23 June 2016 to leave the European Union.

3. Any amendments to the SSE regime need to be viewed in the wider context of the UK tax regime but a more favourable, less complex, SSE regime would play an important role in establishing the UK tax regime as genuinely competitive.

4. When the UK leaves the EU regime and no longer benefits from the Parent Subsidiary Directive (PSD) and has to rely on bilateral double tax conventions then there will be less favourable withholding regimes, for instance the withholding tax rate under the current UK Germany Double Tax Convention (DTC) is 5% and not 0% as currently under the PSD. So a review of relevant European DTCs is also imperative.

RESPONSES TO SPECIFIC QUESTIONS

Q 1: To what extent does the SSE currently meet its objectives of i) encouraging rational decision making on restructuring and the disposal of trading entities within a group, and ii) reducing incentives to adopt complex offshore holding company structures?

5. The SSE is well used and it does meet many of its objectives. There are problems around the edges of the regime and it is overly complex.

Q 2: What complexities arise in practice for domestic or foreign headed groups in applying the SSE?

6. There are problems for foreign entities without share capital which cannot be treated as part of the group under existing rules. This applies, for example, potentially to the GmbH entity in Germany and to US LLCs.

7. There are also problems with the 10% shareholding requirement and the 12 month window which can be problematic in IPOs (Initial Public Offerings). We suggest that whether the qualificatory conditions have been satisfied should be tested at the time of the IPO and not subsequently.

8. There can also be problems with large intra group cash balances which may have been created when assets are transferred within groups of companies or though cash pooling and then raise the question as to whether the loan is a trading asset. We believe there should be a reduced emphasis on Balance Sheet type issues when determining whether a group, or a company, is trading.

9. We also believe that property rental businesses should be treated as carrying out trading activities.

10. There is currently a requirement for the company making the disposal to be trading both before and after the disposal. We note that other EU countries do not apply the tests to the vendor company and we support that approach.

Q 3: In what additional situations do you consider the SSE should be available for substantial share disposals and how does this compare to the availability of equivalent exemptions in overseas jurisdictions

11. There can a problem, post the sale, for the vendor company to meet the current UK exemption conditions. This is not a problem in other EU countries which don't apply such tests to the vendor company.

12. There can also be a problem after an IPO which is not the case in other jurisdictions such as Luxembourg and the Netherlands.

13. Question over share capital eg with LLCs and GmbHs can also create issues with the trading test that do not apply in other holding company jurisdictions.

14. Other locations also don't draw the distinction between real estate holding companies and other traders.

Q4: To what extent could reform of the SSE impact on the likelihood of groups locating holding companies in the UK, and what are the potential benefits from an economic and fiscal perspective?

15. Some of the current BEPS incentives put increasing focus of locating where there is substance and this could encourage more groups to look at the UK compared to eg Luxembourg. But our complex SSE hinders this as will our departure from the EU and removal of the PSD (eg leading to withholding tax on dividends from Germany).

Comprehensive exemption:

Q 5: To what extent do you agree with the parameters set out for a comprehensive exemption?

16. We agree with the parameters.

Q 6: To what extent do you consider that a comprehensive exemption for gains on substantial share disposals, that imposes fewer conditions on the nature of the companies involved in the transaction, could address the concerns raised in the previous chapter?

17. A comprehensive exemption appropriately drafted ought to remove all the concerns above. However, a halfway house of simply relaxing some of the current conditions (as discussed below) and removing the vendor company condition could also achieve this.

Q 7: To what extent could the avoidance risks, including enveloping risks, inherent in a comprehensive exemption be dealt with through anti-abuse provisions?

18. It is unclear why there is a concern about avoidance. The rules have been in existence for many years without this being a major issue as far as we are aware. It is hard to see why this would change as a result of relaxations to the definitions.

Q 8: Do you consider that the benefits of a comprehensive exemption would be materially reduced if a trading condition was retained at the investee level? Please provide any relevant examples to support this.

19. This should be satisfactory as long as certain aspects of the investee test are relaxed (eg the emphasis on balance sheet tests). The key current issue is with the vendor test and the participation requirement.

Q 9: Are there alternative tests at the investee level that would still provide sufficient protection against abuse?

20. We recommend a focus more on activities than on numbers and, if numbers need to be key, income is more relevant than assets (to remove the issue of how to classify surplus cash etc).

SSE framework:

Q 10: What benefits would there be in focusing the investing and investee conditions on the companies involved in the transaction? How could such a change be protected from abuse?

21. We think that removing the investor trading test is more important and it is hard to see this leading directly to abuse.

Q 11: Are there changes that could be made to the definition of qualifying activity that would help to better deliver the SSE's policy objectives while maintaining sufficient protection against abuse?

22. We think rental property income should be treated as trading income.

Q 12: In what situations does the definition of a substantial shareholding prevent large and long-term investments benefitting from the SSE? What is the case for these situations being accommodated?

23. As has been mentioned above the conditions are difficult to meet in the context of IPOs since the vendor may still hold less than 10% of the shares 12 months after the sale

Q 13: What other substantive reforms could be considered to make the SSE simpler, more coherent and more internationally competitive?

24. We think that the SSE legislation should override the *Marren v Inglis* rule that unascertained deferred consideration is not part of the sale consideration, it is for general CGT purposes treated as a chose in action. We believe that such consideration should be eligible for SSE exemption.

The funds sector

Q 14: Is there a case for reform of the SSE to be targeted towards the funds sector? How could SSE-qualifying funds be defined for this purpose?

25. No comment

Detailed design

Q15: To what extent does the SSE's focus on ordinary share capital in determining the members of a group create complexity or lead to results that are inconsistent with the policy objective?

26. The focus of the current SSE regime on ordinary share capital causes very great difficulties in relation to foreign subsidiaries and a major part of the advice given by our member firms is concentrated on resolving resultant difficulties.

27. The example discussed in paragraphs 6.4 to 6.7 highlights the fact that substantial interests if held via a partnership do not currently qualify for SSE exemption. We believe that the regime should be amended to allow such interests to qualify in the future.

Q 16: In what situations could delays in the sale of a residual shareholding result in the loss of SSE treatment, and how should this be rectified?

28. This can be a problem in the case of IPOs.

Q 17: In what situations can the post-sale trading requirement create issues that are not accommodated by the existing winding-up provisions?

29. If a group has two separate businesses and one is sold for cash and represents 30% of the aggregate business then the group, post sale, will fail to qualify as a trading group. We do not believe that should automatically be the case.

30. If there is to be a winding up but that winding up is delayed then this may also cause the SSE exemption not to be available. We believe there should be some provision along the lines of the winding up taking place as soon as is reasonably practical. On the other hand the elimination of the vendor SSE condition would also solve the problem.

Q 18: Are there other areas of the SSE legislation that you consider to be ambiguous or producing outcomes that are inconsistent with the policy intention?

31. The interaction between the SSE regime and the provisions in TCGA 1992 sections 135 and 171 are not easy to follow from the legislation itself but the guidance clarifies what happens in practice. If the law is to be amended then this is an opportunity to make the primary legislation clearer to follow and also the policy intent.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax).