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Comments by the Association of Business Recovery Professionals (R3) in response to the Consultation paper issued by HM Treasury.

Reform of the Substantial Shareholdings Exemption: consultation

R3 is the leading professional association for insolvency practitioners (IPs) in the UK, promoting best practice for professionals working with financially troubled individuals and businesses, promoting the work to Government and key policy makers, producing guides for insolvency professionals and members of the public, running courses and conferences to promote learning and best practice within the insolvency profession. Our members (approximately 3,000) work in firms of all sizes, from the global legal and accountancy firms through to smaller local firms and sole practices, and include insolvency lawyers and other professionals working in the insolvency and restructuring professions. Our members cover the whole spectrum of work with financially distressed businesses and individuals including advice, rescue and turnaround, and formal Insolvency Act 1986 appointments.

The response does not seek to comment on the complete consultation document and is restricted to issues affecting insolvency and distressed restructuring. R3 has been helped in the collation of this document by a sub-committee of restructuring tax practitioners who are from each of the Big 4 accountancy firms, Grant Thornton, Mazars, Smith & Williamson and specialist tax counsel. We recognise that this is a specialised area. R3, and the specialist tax committee that works with us, would be happy to answer any further queries you may have or to provide technical or practical aid and advice in matters affecting insolvent and rescue situations.

It is important to note that common features of distressed companies are volatile trading results, normally within a relatively short concentrated period, poor quality of information, a changing management team and a generally unstable business environment together with inaccessibility or unwillingness of management, previous advisors or even remaining solvent members of the group to provide information.

The Substantial Shareholdings Exemption ("SSE") is generally regarded as a useful and beneficial exemption and is regularly relied upon by Insolvency Practitioners when, as part of their duties during a formal insolvency appointment over a corporate, they sell shareholdings in subsidiaries. That said, Insolvency Practitioners do encounter the issues faced more widely when assessing whether the disposal would meet the requirements to obtain the SSE. Therefore, the consultation has been well received and all of the proposals would be beneficial for insolvent cases.

In response to Question 13 R3 consider that SSE could be made simpler and more coherent by clarifying certain parts of the legislation.

Legislative references below are to Schedule 7AC TCGA 1992 unless otherwise stated.

Chapter 4 – Options for possible reform

Clarification of Paragraph 3 – Subsidiary exemption: disposal of shares or related asset where main exemption conditions previously met

The underlying purpose of this paragraph is to exempt chargeable gains and losses in situations where the criteria aren't met at the time of disposal but were met at an earlier point of time (currently within 2 years of the date of disposal). Whilst this extension to the main exemption is understood, and assuming the principles do not change as a result of this consultation process, it would be helpful if the legislation were made easier to interpret and we would recommend that this is redrafted. In particular Paragraph 3(3) has been a long standing point of confusion and can take some time to work through to reach the intended interpretation.

Also in Paragraph 3(3), reference to the winding up or dissolution taking place 'as soon as is reasonably practicable in the circumstances' is subjective and has itself been the subject of a number of advance non statutory clearance applications. Reference to a particular time frame whilst allowing for exceptions as the board may permit would generally provide more certainty. By way of example, in the Entrepreneurs' Relief provisions, the legislation allows a time period of three years following cessation of trade for the company to be liquidated with the individual able to claim this relief upon the proceeds from liquidation.

This would provide comfort and certainty in the majority of cases whilst allowing the flexibility to the Board to extend the timeframe in larger insolvency cases (for example an administration which may take a number of years to conclude before entering liquidation). HMRC guidance could also include examples of situations that would be regarded as reasonable exceptions (and to which an extension should be granted by the board) to help exceptions work in practice when they arise and allow straightforward communication between the Insolvency Practitioner and the Board.

Paragraph 16 – effect of investing company's liquidation

This paragraph itself refers to a very specific situation in which a Liquidator applies to the Court to have the assets of the company in liquidation vested to him. This is unlikely to occur in practice as, in the majority of cases, a Liquidator can adequately perform his duties, including the realisation of available assets legally owned by the company, without applying to the Courts to have the assets vested in them. To highlight how unlikely this scenario actually is, of the thousands of liquidations that the tax technical committee have been involved with over the years, members can recall two cases in which this action was considered necessary.

Historic case law has determined that a company in liquidation loses beneficial ownership of its assets (although a company in liquidation will generally retain legal ownership of the assets, subject to terms of contracts / retention of title claims etc).

Based upon current practice agreed over time with HMRC and current guidance within the Capital Gains Tax Manual at CG53076 (extract detailed below) it is understood that it is this loss of beneficial ownership and the underlying issues this could have upon the availability of SSE in liquidation scenarios that this paragraph is intended to help resolve.

Within the chargeable gains grouping provisions, the loss of beneficial ownership in a liquidation is overcome by S170(11) TCGA 1992 which makes reference to the winding up of a company not being regarded as an occasion for that company (or any other) to cease to be a member of the group. Whilst the provisions of the SSE are being amended, could the wording of Paragraph 16 be drafted along these lines to make reference to liquidation / winding up / or formal insolvency process (should it be necessary to also clarify the position for an Administrator selling shares within an administration) not being an occasion for the company to lose ownership of the assets for the purposes of SSE?

Capital Gains Tax Manual at CG53076

TCGA92/SCH7AC/PARA16

Paragraph 16 Schedule 7AC TCGA 1992 applies where the investing company, or a member of its group, is in liquidation. It makes it clear that although the assets of a company in liquidation vest in the liquidator the company is still, for the purposes of establishing whether the substantial shareholding requirement is met, treated as the beneficial owner of those assets.

So in the example at CG53074, if the subsidiary company went into liquidation then, for the purposes of Part 2 of Schedule 7AC,

- *it would continue to be treated as if it were the beneficial owner of the shares it held,*
- *it would continue to be treated as if it were entitled to the distributable profits and assets that went with those shares,*
- *it would continue to be treated as if it held the holding company's shares, and enjoyed the rights attached to those shares, and*
- *the holding company would continue to be treated as if it held the subsidiary's shares, and enjoyed the rights attached to those shares.*