



ASSOCIATED COMPANIES – NEW RULES FROM APRIL 2011

Two things affect the rate of corporation tax (CT) paid by a company – the level of its profits, and the number of “associated” companies it has.

A company with no “associates” will pay CT at 21% (20% from April 2011) if its profits are less than £300,000, and at 28% (27% from April 2011) if its profits are over £1.5million. Profits between £300,000 and £1.5 m are taxed at a “marginal rate” of 28.75% (from April 2011).

If a company has any “associated” companies, however, the £300,000 and £1.5m thresholds are divided by the total number of associated companies, so a company with one associate will start paying the marginal rate of CT on profits over £150,000. With two associated companies, the marginal rate kicks in at £100,000.

What is an “associated” company?

A company is associated with another company if one controls the other, or if the same person or group of persons control them both. When working out who controls a company, you do not just look at the number of shares an individual shareholder owns – you also add in shares held by his “associates”. “Associates”, broadly, means close family. If, for example, there are two brothers, and brother A owns all the shares in A Ltd, and his brother B owns all the shares in B Ltd, then the legislation says that A Ltd and B Ltd are “associated”, because you have to add the brothers’ shareholdings together.

This can and does lead to absurdities, and so HMRC operate an extra statutory concession (ESC C9) whereby they will only look at the shares held by a person’s spouse and minor children, and ignore shares owned by other relatives. In order to qualify for the concession, there has to be “no substantial commercial interdependence” between the companies. This obviously leads to disputes between tax advisers and HMRC as to the level of “commercial interdependence” between potentially “associated” companies, and whether it is “substantial” enough to mean that ESC C9 did not apply.

Finance Bill 2011

The recently published draft legislation to be included in the 2011 Finance Bill will put the concession on a statutory footing, and will give more generous relief for potentially “associated” companies. Unless there is “substantial commercial interdependence” between two companies, the shares held by ALL associates will be ignored, so from April 2011 it will be possible for a husband to own all the shares in one company, and his wife to own all the shares in another, and provided there is no substantial commercial interdependence between the two companies they will not be treated as associated.

What is “commercial interdependence”?

Along with the draft legislation, HMRC have published draft secondary legislation and guidance, which says two companies are “commercially interdependent if they are:

- Financially interdependent, and/or
- Economically interdependent, and/or
- Organisationally interdependent

Financially interdependent

This means that one company is supporting the other by lending it money or guaranteeing its borrowings, or if they both have a financial interest in the same business.

Economically Interdependent

This is where they have the same economic objectives, or where the activities of one company benefit the other, or where they have customers in common.

Organisationally Interdependent

This occurs where the two companies have the same management, or employ the same people, or share premises or equipment.

It will take a while for everyone to get used to the new rules, but potentially they are a useful modernisation of the rules for associated companies, and will mean that it will be less likely that companies will find themselves “associated” when in fact they have nothing to do with each other.

This article by James Bailey first appeared in Tax Insider magazine (www.taxinsider.co.uk)