# CHAPTER 4

# ASSOCIATED COMPANIES

## 4.1 Definition

Companies are **associated** with each other if **one company controls another company, or two companies** are **controlled by the same person** or persons. CTA 2010, s.25(4)

The **definition of person** in the Corporation Tax Act is very wide. It includes, for instance, a **company**, an **individual**, or **individuals**, **trustees** of a trust, or **partners** in a partnership. For instance if ICI plc has two subsidiaries, both of them 'controlled by' ICI, all 3 companies are associated.

**Control** means **more than 50%** of **any** of the following: CTA 2010, s.25(5)

CTA 2010, s.450

(i) Voting power; or

(ii) Ordinary share capital (not fixed rate preference shares); or

(iii) Entitlement to distributable profits; or

(iv) Entitlement to assets on a winding up.

**Illustration 1**

Which of the following companies are associated?

a) Rat Ltd, a company in which Mickey owns 50% of the ordinary shares.

b) Mole Ltd, a company in which Mickey owns 40% of the shares which entitle him to 60% of the distributable profits.

c) Mouse Ltd, a company owned entirely by Mickey.

d) Cheese Ltd, a company wholly owned by Mouse Ltd.

e) Trap Ltd, a company in which Mouse Ltd owns 10% of the shares but has 55% of the voting power.

To determine the number of associated companies we must identify which companies are under common control.

The control condition is more than 50% of any of voting power, shares, distributable profits or assets on winding up.

Rat Ltd is not controlled by Mickey but all of the other companies are.

Mouse Ltd, Mole Ltd, Cheese Ltd and Trap Ltd are all under the common control of Mickey and hence there are 4 associated companies.

## 4.2 Implications

The existence of associated companies means that:

- **When computing** FII (Franked Investment Income) we **ignore** any **dividends received from associated companies**. CTA 2010, s.32(2)

- The **corporation tax limits** of £1.5 million and £300,000 are **divided equally among all of the associated companies.** CTA 2010, s.24

Therefore in the previous illustration, in computing Mouse Ltd's corporation tax liability we would ignore any dividends received from Cheese Ltd or Trap Ltd and we would divide the corporation tax limits by four as there are a total of four associated companies.

Note that it is these revised limits that are used in any marginal relief calculation.

### Illustration 2

Iain Ltd has the following income for the year ended 31 March 2011:

| | |
|---|---|
| TTP | £120,000 |
| Dividends received from non-associated companies | £18,000 |
| Dividends received from associated companies | £45,000 |

We will assume that Iain Ltd has:

(a) one associated company

(b) two associated companies

(c) twelve associated companies

and we will show how the corporation tax liability is calculated in each case.

To compute the CT liability:

**Step One:**
Consider the corporation tax limits and divide by the total number of associated companies. Remember to include Iain Ltd itself!

| | (a) | (b) | (c) |
|---|---|---|---|
| £300,000 & £1,500,000 divided by | | | |
| (a) 2 | £150,000 & £750,000 | | |
| (b) 3 | | £100,000 & £500,000 | |
| (c) 13 | | | £23,077 & £115,385 |

**Step Two:**
Calculate the "augmented profits":
Ignore dividends from associates.

| | (a) | (b) | (c) |
|---|---|---|---|
| TTP | 120,000 | 120,000 | 120,000 |
| FII £18,000 x 100/90 | 20,000 | 20,000 | 20,000 |
| Augmented profits | 140,000 | 140,000 | 140,000 |

**Step Three:**
Decide which tax rate applies (FY 2010):

| | (a) | (b) | (c) |
|---|---|---|---|
| | 21% | Marginal | 28% |

**Step Four:**
Compute the corporation tax liability:

| | (a) | (b) | (c) |
|---|---|---|---|
| (a) £120,000 x 21% | **£25,200** | | |
| (b) £120,000 x 28% | | 33,600 | |
| Less: $\frac{7}{400} \times (£500,000 - 140,000) \times \frac{120,000}{140,000}$ | | (5,400) | |
| | | **£28,200** | |
| (c) £120,000 x 28% | | | **£33,600** |

## 4.3 Other rules

Companies are **associated for a whole chargeable accounting period.** Therefore, we include companies that join or leave the group during the year, even though they are only associated for part of the period. CTA 2010, s.25(1)

We also **include all worldwide companies**. Although normally only UK resident companies are subject to corporation tax, existence of worldwide subsidiaries or holding companies will dilute the upper and lower limits.

**Dormant companies are excluded.** A dormant company is basically one that is not doing anything. In *Jowett v O'Neill v Brennan Construction Ltd,* a company simply holding funds in a bank deposit account and receiving interest income, was not an active company and counted as dormant for associated company purposes. Prior to this decision, the Revenue believed that a company was only dormant if it had no income. From this decision, the **company is dormant provided it has no activity.** CTA 2010, s.25(3)

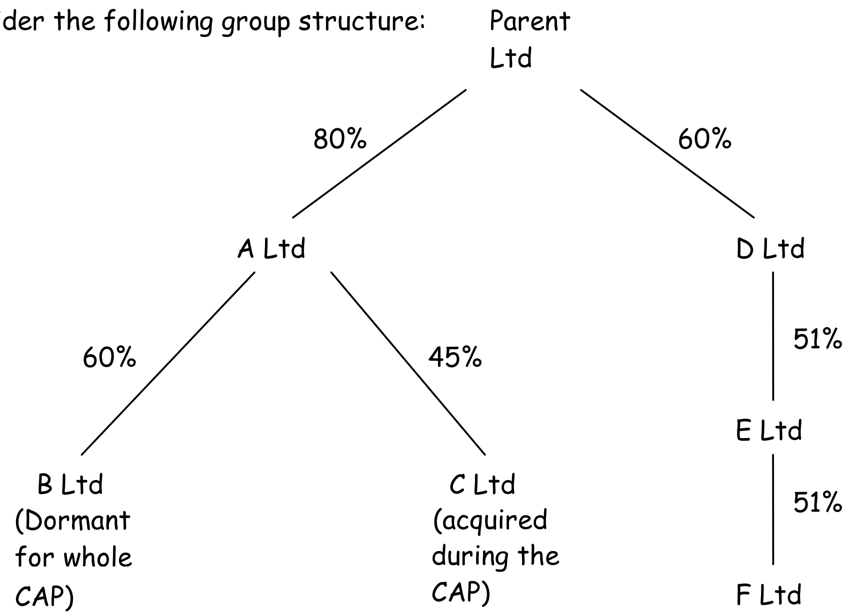
## 4.4 Sub-subsidiaries

Sub-subsidiaries, i.e. where one company controls another, which in turn controls another, are **also included as associated companies**. The definition is a very wide one.

Therefore, if one company controls another and that controls another, we **do not need to multiply the holdings downwards** to work out whether one company owns more than 50% of another.

**Illustration 3**

Consider the following group structure:




Which companies are associated with Parent Ltd for the year ended 31 December 2010?

Parent Ltd controls A Ltd, B Ltd, D Ltd, E Ltd and F Ltd. However, B Ltd is a dormant company and is therefore ignored.

A Ltd, D Ltd, E Ltd and F Ltd are all therefore associated with Parent Ltd. The profit limits will be divided by five for each of these companies in calculating their corporation tax liabilities.

## 4.5 Associates

When determining whether companies are associated, the holdings of an individual must be added to holdings of his 'associates'. CTA 2010, s.448

**Associates include** the individual and his **relatives and any business partners** with whom the individual is trading in partnership. The definition does not extend to individuals who are directors in the same company.

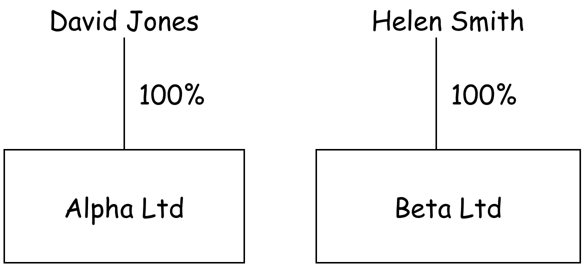
Relatives are defined as the individual's spouse or civil partner, plus also his brothers and sisters, children and remoter issue, i.e. grandchildren etc, parents and remoter forbear, i.e. grandparents etc. CTA 2010, s.448(2)

The rights or powers held by business partners will only be attributed when 'relevant tax planning arrangements have at any time had effect in respect of the taxpayer company.' This is discussed in more detail below. CTA 2010, s.27

We also apportion the rights and powers of trustees, where the settlor is the individual or an associate of that individual. The settlor is the person who actually puts the money into the trust.

**Illustration 4**

David Jones and his sister, Helen Smith, own the following shareholdings:




In determining whether companies are associated the shareholdings owned by David Jones must be added to those of his sister, Helen Smith.

Therefore, according to the definition of associates, Alpha Ltd and Beta Ltd are under common control and we must divide the profit limits by two for each company in order to calculate their corporation tax liabilities.

## 4.6 Concession

The treatment in illustration 4 above seems unfair, particularly if Alpha Ltd and Beta Ltd are two completely independent companies.

For this reason HMRC will treat the definition of a relative, for the purposes of determining associated companies, as including only a spouse/civil partner or minor child so long as there is no "substantial commercial interdependence" between the two companies. ESC C9, Para.5

There is no clear definition of what is "substantial commercial interdependence". HMRC will look at all the facts of each case. HMRC have indicated that it means reliance on each other. This is not necessarily a financial test and can relate to factors that cannot be measured numerically. It is the overall picture that must be considered and not each factor in isolation.

The following list is not exhaustive but you should look at factors such as:

- shared directors or administration,
- shared facilities,
- purchasing or selling arrangements,
- inter-company loans or guarantees.

Therefore, provided there is no substantial commercial interdependence between the two companies, Alpha Ltd and Beta Ltd in the previous illustration will not be associated companies.

Remember, that shareholdings your spouse/civil partner or minor child hold will always be considered in determining which companies are associated regardless of whether substantial commercial interdependence exists or not.

## 4.7 Holding companies

Pure **holding companies will be treated as dormant** provided that all of the following apply: CTA 2010, s.26

- It has no assets other than shares in 51% subsidiaries.
- It is not entitled to any deductions for qualifying charitable donations or management expenses in respect of any outgoings.
- It has no income or gains other than dividends which it has distributed in full to its members.

Therefore in the previous illustration, if Parent Ltd had no assets other than its shareholdings, no expenses and no income or gains other than dividends received from its 51% subsidiary companies which it distributed in full to its shareholders, there would only be four associated companies in calculating the corporation tax liabilities of A Ltd, D Ltd, E Ltd and F Ltd.

## 4.8 Associated Companies: Advanced aspects

A company is regarded as an associated company of another if one has control of the other or if both are under the control of the same person or persons. (Note, the term “associated company” is not restricted to UK resident companies).

We have already seen that special rules apply in relation—

(a) dormant companies;

(b) holding companies; and

(c) changing numbers of associated companies throughout an accounting period.

Clearly, the reference to “person or persons” ensures that companies are associated companies if they are under common control of individuals or trustees, as well as companies. “Control” is construed in accordance with CTA 2010, s.450.

### *Minimum controlling combination*

HMRC guidance states that whether or not two companies are under the control of the same person is obvious once the control tests in CTA 2010, ss.450-451 have been applied to both companies. However, in determining whether two companies are under the control of the same *persons*, HMRC establish which group or groups of persons control each company. They only regard the two companies as under the control of the same persons if—

(a) a group which controls one company is identical with a group which controls the other; and

(b) for each company, that group is a “minimum controlling combination”.

They take the term “minimum controlling combination” to mean a group of persons which has control of the company but which would not have control of it if any one of the persons were excluded from the group. They give the example of three unconnected persons, A, B and C, each holding one third of the shares in a company. In this situation there are three minimum controlling combinations; A and B together, B and C together, and A and C together. As control is held by any two together, the addition of another person to the controlling combination is superfluous and HMRC would not also need to contend that A, B and C together control the company. HMRC give the following example.

**Illustration 5**

There are a total of 150 issued shares in Cox Ltd and Banks Ltd. 50 each are held by Mr A, Mr B and Mr C.

Arnold Antiques Ltd has a total of 200 shares, 50 each held by Mr A, Mr B, Mr C and Mr D.

Mr A, Mr B, Mr C and Mr D are not associates.

Cox Ltd and Banks Ltd are controlled by any two together, i.e. Mr A and Mr B together, or Mr A and Mr C together, or Mr B and Mr C together.

Arnold Antiques Ltd is controlled by any three together, i.e. Mr A, Mr B and Mr C together, or Mr A, Mr B and Mr D together, or Mr A, Mr C and Mr D together, or Mr B, Mr C and Mr D together.

As there is no group of persons controlling Cox Ltd and Banks Ltd which is identical with a group of persons controlling Arnold Antiques Ltd, HMRC do not regard the two companies as associated.

However if Mr A and Mr B's shares together entitled them to the greater part of the *voting power* in Arnold Antiques Ltd, then there would be an identical group controlling both companies; and therefore HMRC would regard the two companies as associated.

In other words, two companies are not treated as being controlled by the same group of persons if, in relation to one of the companies, some of them have control without the rest who are nevertheless necessary in order to make up the controlling group in relation to the other company.

**Illustration 6**

A and B are not associated. They are both shareholders in two companies, A Ltd and B Ltd. A controls A Ltd and A and B together control B Ltd. A by himself does not have control of B Ltd. Although A and B together have a controlling interest in both companies, the companies would not in practice be treated as controlled by the same persons because A controls A Ltd independently of B.

### *Attribution of rights of nominees and associates*

In determining whether the control test is satisfied, the legislation provides any rights or powers which a nominee of a person possesses on his behalf, or may be required to exercise on his direction or behalf, are attributed to him. CTA 2010, s.451(3)

The legislation further provides that that there *may* be attributed to any person all the rights and powers of any associates, as defined above. In calculating the rate of corporation tax payable by a company, a partner will only be treated as an associate where "tax planning arrangements" exist. CTA 2010, s.451(3)

"Arrangements" are widely defined to include **any agreement, understanding, scheme, transaction or series of transactions** which involve the participator (e.g. shareholder) and the partner(s) which secure a **"relevant tax advantage"**. However, for these purposes, a relevant tax advantage looks only at whether the company's corporation tax liability is reduced by the company being small or marginal and does not therefore extend to any other type of tax planning.

**Illustration 7**

The Zabadak Partnership is a small accountancy firm with five partners, Dave, Dozy, Beaky, Mick and Titch.

Dave also owns a 60% equity interest in Xuanadu Ltd, which carries on a property investment business.

Mick (together with his wife) owns 100% of Legend Ltd, which operates a profitable music concert promotions business.

Provided there are no relevant tax planning arrangements in place, Xuanadu Ltd and Legend Ltd will not be associated with each other for the purpose of determining the rate of corporation tax payable.

The wording of the attribution provision (before amendment by FA 2008), and in particular the use of the word "may", was examined in *R v IRC, ex p Newfields Development Ltd (2001)*. In that case, HMRC successfully argued that they had no discretion to exercise the attribution under this provision. Instead, HMRC must examine all the possible combinations (including all the attributions, only some of the attributions and no attributions at all); if any combination of person or persons satisfies the tests, then the necessary control has been established. The House of Lords held that HMRC correctly attributed to an individual all the rights and powers of trustees in respect of two companies, and that such attribution should take place, so that the individual was treated as controlling both companies.

This decision was followed in *Gascoines Group Ltd and Ors v Insp of Taxes (2004)* where the High Court held that where a person has control for the purposes of what is now CTA 2010 ss.448-454, that person was also taken to have control for the purposes of CTA 2010 s.25(4).

**Example 1**

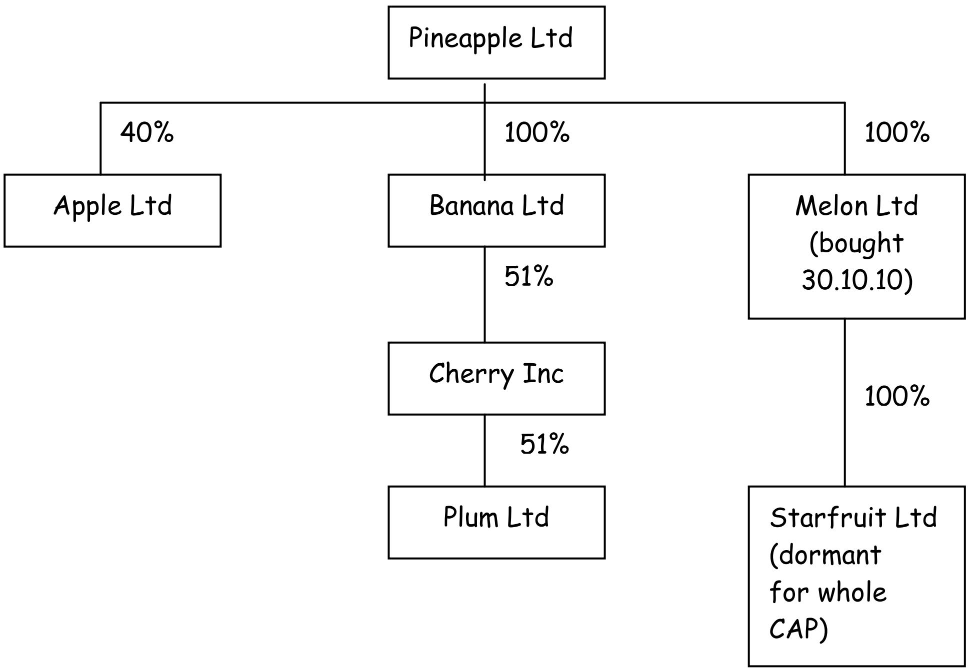
Plant Ltd and Flower Ltd each have 2 associated companies. Their profits in the year ended 31 March 2011 are as follows:

| | Plant Ltd | Flower Ltd |
|---|---|---|
| | £ | £ |
| TTP | 450,000 | 120,000 |
| FII | 60,000 | 30,000 |

**Calculate the corporation tax liability for each company.**

**Example 2**

Consider the following group structure:




The group prepares accounts to 31 December each year.

**How many associated companies are there in the year ended 31 December 2010?**

**Example 3**

Sam invites the following people round to dinner:

a) His brother

b) His brother's wife

c) His godson

d) His ex-wife

e) His business partner

f) His grandmother

g) His bank manager.

**Who is associated with Sam?**

**Answer 1**

| | Plant Ltd | Flower Ltd |
|---|---|---|
| | £ | £ |
| TTP | 450,000 | 120,000 |
| FII | 60,000 | 30,000 |
| Augmented profits | £510,000 | £150,000 |

Adjusted profit limits (Each company has 2 associated companies = a total of 3 associates):

| | | |
|---|---|---|
| £1,500,000/3 = £500,000 | >500k | Between limits |
| £300,000/3 = £100,000 | | |

Therefore Plant Ltd is a large company and Flower Ltd is marginal. The whole chargeable accounting period falls in FY 2010.

| | £ | £ |
|---|---|---|
| Corporation tax liability: | | |
| £450,000 x 28% | **£126,000** | |
| | | |
| £120,000 x 28% | | 33,600 |
| Less marginal relief: | | |
| $\frac{7}{400}$ (£500,000 – 150,000) x $\frac{120000}{150000}$ | | (4,900) |
| | | |
| Corporation tax liability | | **£28,700** |

**Answer 2**

Pineapple Ltd, Banana Ltd, Cherry Inc, Plum Ltd and Melon Ltd are all associated for the year ended 31 December 2010. The profit limits will therefore be divided by 5 for each of these companies in calculating their corporation tax liabilities.

Apple Ltd is not under common control and Starfruit Ltd is dormant for the whole CAP, therefore they are ignored.

Associates include overseas resident companies and companies bought or sold during the period.

**Answer 3**

**(a)**, **(e)** and **(f)** only

Be aware that the shares held by business partners will only be attributed to the individual when 'relevant tax planning arrangements have at any time had effect in respect of the taxpayer company'.
*(CTA 2010 s.27 and s.448)*