

# ASSOCIATED COMPANIES – PRIOR TO 1 APRIL 2015

**Tolley® Guidance**

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## Associated companies - prior to 1 April 2015

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### Implications

The existence of associated companies means that the corporation tax limits of £1.5m and £300,000 are divided equally among all of the associated companies. It is these revised limits that are used to ascertain a company's rate of tax and to calculate any marginal relief. The impact of this is that the greater the number of associated companies within a group, the greater the chance of each company being taxed at a higher rate. See [Example 1](#) for an illustration.

[CTA 2010, s 24](#)

However, corporation tax rates are being unified from 1 April 2015 and from this date, large and small companies will be taxed at the same single rate. As a consequence, the existing rules on associated companies are being replaced as they will no longer be necessary. The associated companies legislation is also relevant to a number of other areas of tax including the patent box regime, the capital allowances long life assets rules and the quarterly instalment payment rules. Finance Act 2014 introduces new, simpler associated companies rules based on a 51% group company test for these purposes. See the [Future associated companies rules and corporation tax rate changes](#) news analysis item for further information on the new rules.

The remainder of this guidance note focuses on the associated companies rules which continue to apply until 1 April 2015.

### 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 Taxes Acts is very wide. It includes, for instance, a company, an individual or individuals, trustees of a trust, or partners in a partnership. For example, if ICI plc has two subsidiaries, and both of them 'controlled by' ICI, all three companies are associated.

The definition of 'control' is the same as that used for the close company rules, with some modifications. For further information on the definition of control, and the rules regarding the attribution of rights or powers, see the [Further definitions guidance note](#). The definitions are modified for the purpose of the associated company definition as follows:

- there are differences in the definition of 'associates' for the purpose of attribution of associates' rights and powers to a person. These rules, which were introduced by [Finance Act 2011](#), are discussed in more detail below. ([CTA 2010, s 27](#))
- where a bank/other commercial lender would otherwise control a company by virtue of holding fixed rate preference shares, it is not deemed to have control ([CTA 2010, s 28](#))
- if the only connection between two companies is of loan creditor, this is ignored if either the creditor is not close, or the creditor relationship is part of the ordinary course of the creditor's business ([CTA 2010, s 29](#))

- where companies are under common control only by virtue of attributing rights or powers as trustees by the controlling person, then they are not treated as under common control for this purpose ([CTA 2010, s 30](#))

Please see [Example 2](#) which illustrates the definition of associated companies.

Overseas companies are included. Although only UK companies are subject to UK corporation tax, existence of worldwide subsidiaries or holding companies will further dilute the upper and lower limits.

On the other hand, dormant companies are excluded from the number of associates. A dormant company is essentially a company with no activity. In *Jowett v O'Neill v Brennan Construction Ltd*, a company simply holding funds in a bank deposit account and receiving interest income was held not to be an active company and was dormant for associated company purposes. Prior to this decision, HMRC believed that a company was only dormant if it had no income.

*Jowett v O'Neill v Brennan Construction Ltd* [1998] STC 482 (subscription sensitive)

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

See [Example 3](#) for an illustration.

### **Holding companies**

A holding company will be treated as dormant provided that all of the following apply:

- 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

[CTA 2010, s 26](#)

### **Changes during the accounting period**

Companies are associated for a whole chargeable accounting period if they are associated at any point in time during the accounting period. Therefore, companies that join or leave the group during the year are included, even though they are only associated for part of the period. Therefore it is particularly important to review the position in the accounting period immediately following a transaction involving subsidiaries.

[CTA 2010, s 25\(2\)](#)

### **Associates and attribution of rights and powers**

In determining whether the control test is satisfied, the legislation provides that 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.

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

[CTA 2010, s 448](#)

The rules regarding the attribution of rights held by a person's associates were changed by [Finance Act 2011](#) and so the precise definition differs depending on whether the accounting period ends before, on or after 1 April 2011. Associates include the individual and his 'relatives', and certain 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, together with his brothers and sisters, children and remoter issues, ie grandchildren etc, parents and remoter forbear, ie grandparents etc. Concession [ESC C9](#) offers more favourable treatment where companies are associated because of relatives, other than spouses or minor children.

Rights and powers of trustees are also apportioned where the settlor is the individual or an associate of that individual.

The precise rules are explained below for both pre and post [FA 2011](#).

### **Accounting periods ending on or after 1 April 2011**

Following a period of consultation, the rules regarding the attribution of rights held by a person's associate were changed with effect for accounting periods ending on or after 1 April 2011. See [Autumn tax updates and draft FB 2011 clauses — Tax Information and Impact Notes](#)) for further background to the changes.

In summary, rights and powers of associates are only attributed based on the new 'substantial commercial interdependence' test, which applies to all forms of associates (definition explained above).

[CTA 2010, s 27](#)

The amendment gives statutory treatment to former [ESC C9](#) (the contents of which are summarised below) which limits the attribution of rights to a person of his 'associates' to situations where there is 'substantial commercial interdependence' between two companies. Unlike [ESC C9](#), however, the amended legislation does not exclude relationships between individuals and their spouses or minor children even though they are 'relatives'. This is good news for spouses who own companies which are treated as associated under the current rules, for example, even though there is no other link between the companies.

As well as giving statutory treatment to [ESC C9](#) (with the extension to spouses etc. noted above), the amendments to the rules also change the position in respect of business partners. Under the pre-1 April 2011 rules, which are discussed further below, since 1 April 2008 rights or powers held by business partners were only attributed where 'tax planning arrangements' existed. The new 'substantial commercial interdependence' test replaces these rules.

[CTA 2010, s 451\(3\)](#)

### **Substantial commercial interdependence**

Secondary legislation prescribes the factors which determine whether there is 'substantial commercial interdependence' for this purpose. This has effect for accounting periods ending on or after 1 April 2011. The draft secondary legislation as originally published by the Treasury was accompanied by draft HMRC guidance intended for inclusion in the Company taxation manual (at the time of writing this had not yet been updated in the manual).

[SI 2011/1784](#)

[Small Profits Rate: Associated Companies - Draft secondary legislation and guidance](#)

According to the secondary legislation, the factors taken into account in determining 'substantial commercial interdependence' between two companies are as follows:

- financial interdependence (in particular, where one company gives direct or indirect financial support to the other, or two companies together have a financial interest in another business)
- economic interdependence (in particular if they seek the same economic outcome, one undertakes activities benefiting the other, or they have common customers); or
- organisational interdependence (share common management, employees, premises or facilities)

The draft guidance states that 'the practical application of the rules will vary depending on the facts of each particular case'.

Previously, guidance on the definition of 'substantial commercial interdependence' was in [ESC C9](#) - this is discussed further below.

See [Example 4](#).

For further guidance on the definition of 'Associates' and 'Control' see the [Further definitions](#) guidance note.

### **Accounting periods ended before 1 April 2011**

As mentioned above, for accounting periods ended before 1 April 2011 (and since 1 April 2008) a business partner was only treated as an associate where 'tax planning arrangements' existed. 'Arrangements' are widely defined to include any agreement, understanding, scheme, transaction or series of transactions which involve the participator (eg shareholder) and the partner(s) which secure a 'relevant tax advantage'. For these purposes, the definition of relevant tax advantage is based on the reduction of the company's corporation tax liability by operation of the small profits rate or marginal relief.

For periods ended before 1 April 2011, [ESC C9](#) offered a more favourable treatment for companies which would be treated as associates even though they are in effect completely independent from one another. Under [ESC C9](#), rights of a person's relatives were only attributed to him where there was 'substantial commercial interdependence' between the two relevant companies. Under [ESC C9](#), this treatment was not available in respect of a person's spouses / civil partners and minor children - this position is amended by [Finance Act 2011](#) as discussed above.

HMRC indicated previously that the meaning of 'substantial commercial interdependence' was the reliance by two companies on one another. 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 the following factors may be relevant:

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

## 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 have been applied to both companies. See [CTM03730](#). HMRC will establish which group or groups of persons control each company and will only regard the two companies as under the control of the same persons if:

- a group which controls one company is identical with a group which controls the other; and
- for each company, that group is a 'minimum controlling combination'.

HMRC takes 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 achieved 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 gives the following example:

There are a total of 150 issued shares in Cox 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 and Bank Ltd is controlled by any two together, ie 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, ie 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 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 (albeit by a separate test in [CTA 2010, s 450\(5\)](#) 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.

*Ghelanis Superstore and Cash and Carry Limited v HMRC* ([\[2014\] UKFTT 111 \(TC\)](#)) (subscription sensitive) usefully demonstrates how the minimum controlling combination test is to be applied in determining whether companies are associated with one another. See the [Associated companies - the Ghelanis case](#) news item for an in-depth review of the case and the implications for practitioners and clients.

See [Example 5](#).

## HMRC Toolkit

"HMRC Toolkit: Small Profits Rate and Marginal Relief" offers guidance on the areas which HMRC sees as prone to error. See [LNB News 04/08/2010 30](#) for the 2014 version of the Toolkit, which has been updated to reflect the recent changes in the rules.