



HM TREASURY



HM Revenue
& Customs

Simplification review:

**the associated company rules as they apply
to the small profits rate of corporation tax –
a summary of consultation responses**



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1

Introduction

1.1 In October 2009 the previous Government published the consultation: *Simplification review: the associated company rules as they apply to the small companies' rate of corporation tax*. The Government confirmed in the emergency Budget on 22 June 2010 that it will introduce the proposed reform in Finance Bill 2011, with the legislation taking effect from 1 April 2011.

1.2 This document summarises the responses received to the consultation and also reflects further discussions with interested parties. It also includes revised draft legislation and guidance shaped by those responses. Further comments on the legislation and guidance are welcome.

2

The consultation

Background to the review and consultation

2.1 Following the launch of the Related Companies Simplification Review at the 2007 Pre-Budget Report, the previous Government published an online survey on corporation tax rules for related companies to identify which areas of these rules were possible candidates for simplification. Over 140 responses were received from a range of interested parties, including professional tax advisers and representative groups. In December 2007, the previous Government issued an update on the review, outlining four areas identified as having potential for reform. One of these was the associated company rules as they apply to the small profits rate of corporation tax (SPR).¹

2.2 In the Finance Act 2008, the previous Government simplified the existing rules defining control of a company where a director or shareholder is separately in a partnership. However, this was only a first step in simplifying the rules, and discussions continued with representative bodies to identify how the rules could be further reformed. These discussions identified the main priority for reform as the rules governing control of a company through the attribution of rights held by one or more of their associates. A consultation document was published in October 2009 and can be found at http://www.hm-treasury.gov.uk/consult_simplification_review.htm.

Purpose of the consultation

2.3 Corporation tax was introduced in 1965 as an annual tax on the profits of companies. Initially, a single rate of corporation tax for a financial year applied to all companies irrespective of their level of taxable profits. Finance Act 1972 introduced a lower rate of corporation tax for companies with small profits. From 1 April 2010-11, the SPR is 21 per cent compared to the main rate of corporation tax of 28 per cent. The emergency Budget announced both rates will be reduced in future years: the SPR will fall to 20 per cent from 1 April 2011 and the main rate will be reduced to 24 per cent over 4 years from 1 April 2011.

2.4 The SPR applies to companies whose annual profit does not exceed £300,000 (the 'lower limit'). If a company's profits are above £300,000 but do not exceed £1.5 million (the 'upper limit') the main rate of corporation tax is charged but marginal relief is due.

2.5 Where a company is associated with other companies the corporation tax thresholds (i.e. the lower and upper limits) are reduced accordingly. Broadly, the effect is to adjust the rate of tax to take account of the total profits of all associated companies, ensuring that each associated company's tax rate is reflective of it being part of a wider economic unit. The test for whether companies are associated are the rules governing 'control' of a company set out in section 450 of the Corporation Tax Act 2010.²

2.6 As they apply to the SPR, most aspects of these rules are fully in accordance with the intended policy objective. For example, where companies are part of a group or controlled through rights held by the same person or persons they are associated for the purposes of

¹ Formerly known as the small companies' rate of corporation tax (SCR).

² Previously section 416 of the Income & Corporation Tax Act 1988.

access to the SPR. In discussions prior to the consultation there was broad recognition that it is right that companies within a group or controlled by the same person(s) should be regarded as associated.

2.7 However, some aspects of the rules work in an automatic, mechanical manner that serve to associate companies controlled by separate individuals regardless of the wider circumstances. For example, the rules governing the attribution to a person of rights held by another person linked to them can be unfair. The aim for reform of the existing rules is therefore to provide a test that retains those aspects of the current test that work well within a new test that attributes rights held between linked persons only in circumstances where actual links between the companies make it appropriate to do so. The consultation sought views on a new test that seeks to ensure that companies cannot be associated by an attribution of rights by mere 'accident of circumstance'.

The consultation questions

2.8 The consultation invited responses from interested parties on the consultation questions below:

- 1 Do you feel that the proposed new test ensures that companies would only be associated when their level of interdependence means that it would be appropriate to do so?
- 2 If not, what aspects of the proposed new test should be amended?
- 3 Are there any areas that you feel the draft guidance does not cover and would benefit from further examples?
- 4 Do you have any views on the draft Impact Assessment?

3

Responses to the consultation

3.1 A total of 17 responses to the consultation were received from individuals, businesses and representative bodies. A subsequent meeting was held with interested parties to discuss the specific concerns raised during the consultation about the clarity of the legislation and guidance. A summary of the responses and the Government's response is set out below.

Question 1: Do you feel that the proposed new test ensures that companies would only be associated when their level of interdependence means that it would be appropriate to do so?

3.2 There was wide support for the policy rationale behind the proposed new test. Responses highlighted it as a "sensible" change, "perfectly appropriate", "desirable", and "should result, in the vast majority of cases, with companies being treated as associated when it is appropriate to do so." At the same time, some concerns were raised that moving from a mechanical test to the proposed test might "increase uncertainty" because it would, by necessity, turn on matters of fact and degree. Another considered it might be "unlikely to constitute a simplification" as a result.

3.3 Two responses also suggested the new test did not go far enough because companies controlled through rights held by the same person would remain associated for the purposes of access to the SPR.

The Government's response

3.4 The Government has responded to the main priority identified by stakeholders in the simplification of the associated company rules and welcomes the broad support for the reform so that companies cannot be associated by an attribution of rights by mere 'accident of circumstance'. As set out in the emergency Budget 2010, it will proceed with this reform and introduce legislation in Finance Bill 2011 that takes effect from 1 April 2011.

3.5 The Government does acknowledge the concerns around the possibility of increased uncertainty. This was raised with stakeholders prior to the publication of the consultation when the proposed test was initially discussed. Interested parties considered it to be an inevitable consequence of their desire to move away from the existing automatic, mechanical test towards one based on the individual facts of each case. It was agreed that as a result some uncertainty would always exist but clear legislation, with supporting guidance, would mitigate this and the benefit of the reform would outweigh the potential for uncertainty.

3.6 As set out in the previous chapter, it was agreed with stakeholders prior to the consultation that it would focus solely on the attribution of rights between associates. The new test only amends the circumstances in which rights held by linked persons are attributed between them to establish control.

Question 2: If not, what aspects of the proposed new test should be amended?

3.7 Despite the broad support for the policy change there was concern that the draft legislation lacked clarity and was, in some respects, inconsistent with the draft guidance. Some felt the legislation to be too broad and difficult to interpret without making reference to the guidance. To tackle this, some commented that the principles on which attribution of rights would be based (i.e. economic, financial and organisational interdependence) should be made explicitly in the legislation.

3.8 Others considered a “significance test” or *de minimis* could be included within the legislation to eliminate minor links from creating an association, with s.51G of the Capital Allowances Act 2001 cited as an example of an objective test to prevent the fragmentation of businesses.

The Government’s response

3.9 The Government has revised the draft legislation to express more clearly the circumstances in which rights should be attributed between associated persons. The revised legislation explicitly sets out that rights are only attributed between associates where “substantial commercial interdependence” exists between the relevant companies. In considering where this exists, regard should be had for the level of economic, financial and organisational interdependence between the relevant companies. While lengthening the legislation, the change ensures the policy objective of companies only being associated through attribution of rights in circumstances where the links between them make it appropriate to do so and sets out the relevant circumstances.

3.10 As stakeholders and respondents recognised, “substantial commercial interdependence” can exist in many ways and is thus difficult to define with absolute clarity. The revised legislation therefore takes the form of:

- a high level statement in primary legislation that the rights of linked persons will only be attributed where “substantial commercial interdependence” exists between companies; and
- specific detail, in secondary legislation, of the factors that determine whether “substantial commercial interdependence” exists.

3.11 This approach provides the legislative clarity that respondents requested. The power to set out the factors indicating interdependence by way of Treasury Order has the virtue of giving legislative clarity in a manner that, if required, can be amended in line with changes in the business world without the timing restriction of the annual Finance Bill. Interested parties at a meeting subsequent to the consultation welcomed this revised approach.

3.12 The Government does not believe a significance test is appropriate. Each case under the revised legislation will be dependent on its own facts and tax legislation often turns on such questions of facts and degree. A statutory significance test would create a new “cliff-edge” test of the type this reform seeks to replace. Furthermore, HMRC Extra Statutory Concession C9, on which this reform is based, specifically uses the test of “substantial commercial interdependence”. This test has been well understood and operated for many years without difficulties or the need for an additional significance test.

3.13 The revised draft legislation can be found at Chapter B. Further comments are welcome before the primary legislation is published in the draft Finance Bill 2011.

Question 3: Are there any areas that you feel the draft guidance does not cover and would benefit from further examples?

3.14 Responses on the guidance noted “the guidance is very good although, obviously, it cannot cater for every situation, and most situations will be more complicated than those presented”. The examples were described as aiding “interpretation of the legislation and are transparent as to its intentions”.

3.15 Some responses however suggested the examples in guidance did not provide sufficient clarity because, in some cases, they did not outline the specific interdependence leading to an association. Some also requested the guidance clearly set out the level of economic, financial or organisational interdependence required for companies to be considered associated.

3.16 Responses also made a number of suggestions for further examples that would be helpful to include in the guidance. These included circumstances where:

- spouses or civil partners owning different companies both work at home, while sharing childcare and household responsibilities;
- companies share premises;
- family businesses set up by one generation split into separate businesses when passing into ownership of next generation;
- there is financial assistance from a family member who is in another business;
- there are arms length transactions at commercial rates; and
- a private equity fund invests in a number of independent companies.

3.17 It was also suggested the guidance should include some practical advice about how to resolve any disagreements over interdependence and what additional information HMRC would seek in such instances.

The Government's response

3.18 The proposed revisions to the legislation explicitly set out the factors that must be taken into account when considering whether it is appropriate to attribute rights held by associated persons. While it is impractical for the guidance to cover every scenario, the guidance has been revised wherever possible to include the examples above and make the existing examples clearer. The revised draft guidance can be found at Chapter C and further comments are welcome. Further discussions will be held with relevant stakeholders in relation to private equity and the guidance will be updated to include appropriate examples if necessary.

3.19 The guidance provides practical advice on how HMRC will interpret the legislation in a range of scenarios. It is impractical to set out further what additional information may be required in the event of a dispute as it will depend on the facts of each individual case. Any disputes will be subject to the normal procedures and guidance can be found at www.hmrc.gov.uk/factsheets/hmrc1.pdf.

Question 4: Do you have any views on the draft Impact Assessment?

3.20 Only a small number of comments were received directly about the draft Impact Assessment. They suggested compliance costs could be more significant for some companies because a potentially complex judgement has to be made whether the interdependencies apply.

The Government's response

3.21 The Government acknowledges that the new test will, in some instances, involve a greater burden for the small number of companies that need to consider whether they are associated because of attribution rights. As set out above, this is the consequence of replacing the existing mechanical test in favour of delivering the priority reform requested by stakeholders during the course of the Review. In the majority of instances however, the attribution of rights play no part, or are only a very minor consideration, when deciding whether an association exists. Consequently, the Government believes the draft Impact Assessment represents a fair reflection of the average burden for companies considering matters of association but will make this clearer when producing the final Impact Assessment.

Other issues raised

3.22 The responses also highlighted a number of issues not directly related to the consultation questions.

3.23 One asked whether this meant HMRC Extra Statutory Concession C9 would be withdrawn as a result of these proposals. This states that where there is no substantial commercial interdependence between companies then, for the purpose of access to the SPR, they cannot be considered associated by virtue of an attribution of rights between relatives unless the attribution is between husband and wife or a child who is a minor.

3.24 One response suggested introducing a single rate of corporation tax to remove the need for the associated company rules as all profits would be taxed at the same rate no matter whether companies were associated or not.

3.25 Other responses commented on the scope of the consultation. Some suggested it should have also considered the case for removing the mechanical reduction of the thresholds by reference to the number of associated companies and replace this by applying the SPR to the total profits of all associated companies taken together. Others suggested the Simplification Review should consider the broader application of the associated company rules.

The Government's response

3.26 The Government confirms that HMRC Extra Statutory Concession C9 will be withdrawn when the new legislation is introduced.

3.27 The Government notes the suggested benefits of a single rate of corporation tax in terms of simplification. Tax rates are beyond the scope of this consultation.

3.28 The possibility of applying the SPR by reference to the total profits of all associated companies was discussed in detail with stakeholders prior to publication of the consultation. However, in those discussions there was collective agreement with the difficulties in a reform of this nature and so the published consultation did not focus on it. These difficulties include:

- problems arise when company A is associated with companies B and C but where there is no association between B and C. Company A may have no other associates apart from B and C, so for it thresholds are reduced by two-thirds, whereas company C may have many associates so that its thresholds are reduced to a small fraction. As a matter of policy it is highly difficult to decide the total amount of relief that company B should be allowed to share in and so there is no rational basis for resolving disputes between the companies as to what amount of relief each should get; and

- it would be particularly difficult where accounting periods do not coincide and also where the associated companies are not UK resident or trading within the UK and therefore not within the charge to corporation tax.

3.29 The Government has been unable to find a practical solution to these issues and neither stakeholders prior to the consultation nor those raising the issue again during the consultation have been able to find solutions to resolve these difficulties either. The Government does not therefore currently plan to act but remains open to further discussions if a practical solution can be found.

3.30 The Government also notes the suggestion there is interest in reviewing the associated company rules more broadly. Reforms have been introduced to tackle the specific issues identified as the main priorities identified by stakeholders during the Simplification Review process launched in 2007 and has now delivered on those areas. The associated company rules, as with all taxes, will be kept under review in the future.

4

Next steps

4.1 As announced in the emergency Budget 2010, legislation will be introduced in the Finance Bill 2011 to reform the associated company rules as they apply to the SPR. This will take effect from 1 April 2011.

4.2 The Government is currently consulting on improving the scrutiny of tax legislation.¹ It has proposed a minimum of 8 weeks for comments on draft Finance Bill legislation and 4 weeks for comments on draft secondary legislation where it makes a substantive change to the tax code. Ahead of formal publication for comment consistent with those principles, earlier comments on the draft legislation or draft guidance in Chapters B and C are welcome and can be sent to:

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4.3 The Government has delivered the priorities identified by stakeholders during the scoping stage of the Simplification Review in 2007 and discussions over the past three years. It will now formally close this strand of the Related Companies Simplification Review but will continue to keep the associated company rules under review should further reforms be necessary in the future.

¹ *Tax policy making: a new approach*, HM Treasury, June 2010, http://www.hm-treasury.gov.uk/junebudget_tax_policy_making.htm

A List of respondents

There were 17 responses received to the consultation. The following representative bodies submitted responses, with the remainder being received from individuals, businesses or accountancy firms:

- Association of International Accountants
- Association of Taxation Technicians
- British Venture Capital Association
- Chartered Institute of Taxation
- Institute of Chartered Accountants in England and Wales
- Institute of Directors
- London Society of Chartered Accountants

B

Revised draft legislation

The revised draft primary legislation is set out below. This takes account of comments received during the consultation process and in subsequent discussions.

Small profits rate: associated companies

(1) Section 27 of CTA 2010 (meaning of “associated company”: attribution to persons of rights and powers of their partners) is amended as follows.

(2) In the heading, for “their partners” substitute “associates”.

(3) In subsection (1), omit “(“the taxpayer company”)

(4) In subsection (2), for “(“P”) include a partner of the person” substitute “have effect for the purposes of this section”.

(5) For subsections (3) to (6) substitute-

“(3) The condition is that there is substantial commercial interdependence between the companies.

(4) The Treasury may by order prescribe factors that are to be taken into account in determining whether a relationship between two companies amounts to substantial commercial interdependence for the purposes of this section.”

The draft secondary legislation and explanatory note is set out below. This takes account of comments received during the consultation process and in subsequent discussions.

The Corporation Tax Act 2010 (Factors Determining Substantial Commercial Interdependence) Order 2011

The Treasury makes the following Order in exercise of the powers conferred by sections 27(4)(a) and 1171(4) of the Corporation Tax Act 2010⁽¹⁾.

Citation and commencement

1. —(1) This Order may be cited as the Corporation Tax Act 2010 (Factors Determining Substantial Commercial Interdependence) Order 2011.

(2) This Order shall come into force on [day] [month] 2011.

⁽¹⁾2010 c. 4. Section 27(4) was inserted by section XX of the Finance Act 2011 (c. XX).

Factors taken into account in determining substantial commercial interdependence

2. In determining for the purposes of section 27 (meaning of “associated company”: attribution to persons of rights and powers of their associates) of the Corporation Tax Act 2010 whether there is “substantial commercial interdependence” between two companies, the following factors are to be taken into account—

- (a) the degree to which the companies are financially interdependent,
- (b) the degree to which the companies are economically interdependent, or
- (c) the degree to which the companies are organisationally interdependent.

“Financially interdependent”

3. Two companies are “financially interdependent” for the purposes of article 2 if (in particular)—

- (a) one gives financial support (directly or indirectly) to the other, or
- (b) each has a financial interest in the affairs of the same business.

“Economically interdependent”

4. Two companies are “economically interdependent” for the purposes of article 2 if (in particular)—

- (a) the companies seek to realise the same economic objective,
- (b) the activities of one benefit the other, or
- (c) the companies have common customers.

“Organisationally interdependent”

5. Two companies are “organisationally interdependent” for the purposes of article 2 if (in particular) the businesses of the companies have or use—

- (a) common management,
- (b) common employees,
- (c) common premises, or
- (d) common equipment.

Explanatory Note

(This note is not part of the Order)

Section XX of the Finance Act 2011 (c. XX) has amended section 27 of the Corporation Tax Act 2010 (“CTA”) (c. 4).

Section 27 CTA (meaning of “associated company”: attribution to persons of rights and powers of their associates) applies where it is necessary to determine whether, in accordance with section 25(4) and (5) CTA (associated companies), a company is an associated company of another. In applying section 451 CTA (section 450: rights to be attributed etc) in order to make this determination, the references in section 451 to an “associate” have effect for the purposes of section 27 only if the condition in section 27(3) is met. The condition in section 27(3) is that there is “substantial commercial interdependence between the companies”.

Section 27(4)(a) gives the Treasury the power to prescribe factors that are to be taken into account in determining whether a relationship between two companies amounts to substantial commercial interdependence for the purposes of section 27(3). This Order prescribes these factors.

Article 2 provides that in determining for the purposes of section 27 CTA whether there is “substantial commercial interdependence” between two companies, the degree to which the companies are financially, economically or organisationally interdependent is to be taken into account.

Article 3 explains what is meant by “financially interdependent” in this context. This will include where one company gives financial support, whether directly or indirectly, to the other, or where each has a financial interest in the affairs of the same business.

Article 4 explains what is meant by “economically interdependent” in this context. This will include where the companies seek to realise the same economic objective, the activities of one benefit the other, or the companies have common customers.

Article 5 explains what is meant by “organisationally interdependent” in this context. This will include where the businesses of the companies have or use common management, employees, premises or equipment.



Revised draft guidance

The revised draft guidance accompanies the revised draft legislation set out in annex B. It has been amended and added to in light of comments received during the consultation process.

CTM03750 - Corporation Tax: small profits rate: attribution to a person of rights and powers of associates – commercial interdependence with companies controlled by associates

CTA2010/s27 and SI 2011 no. xxxx, CTA2010/s451

When deciding if a person or group of persons has control of a company you look at the rights a person (or his/her nominee) possesses or is entitled to acquire.

However, when deciding if companies are under the common control of a person/s and thus associated, you should, in some limited circumstances, also attribute to them the rights in separate companies held by persons to whom they are linked (i.e. associates - see CTA 2010 s448). Those limited circumstances are when there is substantial commercial interdependence between the companies concerned.

The statutory rules are set out in CTA2010/s27 and Statutory Instrument SI 2011 xxxx. You should bear in mind that the practical application of the rules will vary depending on the facts of each particular case.

CTM03775 onwards gives more details and some examples.

If CTA2009/s27 applies then you attribute to a person the rights of:

- associates (see CTM60150), and
- any companies which the person controls or the person and associates together control.

In both cases, the attributable rights will be inclusive of any rights of their nominees which must be attributed to the associate or company concerned - see CTM03740. However, you must not include the rights of 'associates of associates', that is those attributed to an associate by virtue of CTA2009/s27.

CTM03780 – Substantial commercial interdependence and financial, economic and organisational links

CTA2010/s27, SI 2011 No.xxxx

A company is treated as an associated company of another at a particular time if one of the two has control of the other or both are under the control of the same person (or persons).

From 1 April 2011, there are new rules that determine “control” for the purposes of the small profits rate CTA2009/S18. Under the new rules, attribution of rights held by associates of participators only applies where there is ‘substantial commercial interdependence’ between the two companies concerned.

The purpose of the new rule is to take the existence of other companies into account, for the purposes of the small profits rate, where there is a substantive relationship between the relevant companies but not where any "association" is an accident of circumstance, including circumstance of family relationships that do not extend into business.

Note that the new rules apply only to the attribution of rights held by associates of participators. Rights held by the participators themselves are always taken into account, whether or not there is substantial commercial interdependence between the companies concerned.

When considering whether there is substantial commercial interdependence, you should have regard to the degree of financial, economic or organisational interdependence between the companies concerned. See CTM03785, CTM03790 and CTM03795.

Each case will depend on its specific circumstances. The examples in CTM03785, CTM03790 and CTM03795 illustrate the types of factors indicative of the necessary links between separate companies that are controlled by associated persons, although there will be many others.

For substantial commercial interdependence to exist it is not necessary for all three types of links to exist. For example, if there is a sufficient financial link, one company will be an associated company of another even if no economic or organisational links exist.

However, even if substantial commercial interdependence is not present, two companies may still be associated. For example, a husband and wife may separately own the shares in and run two completely different and separate companies but the husband has made a loan to his wife's company and as part of that loan is entitled to the company's assets if it is wound up. The two companies will be associated, not through the focus of the interdependence rules - attribution of associates' rights - but because the husband will control both companies through his shareholding and rights to assets on winding up.

CTM03785 - Interdependence – financial interdependence

SI 2011 xxxx paragraph 3

Two companies are financially interdependent if (in particular):

- one gives financial support (directly or indirectly) to the other, or
- each has a financial interest in the affairs of the same business.

Examples

R is the major shareholder and director of Company D which provides IT services. His son, S, is the major shareholder and director of Company E which provides business management services. R provided, as a family, rather than business matter, a personal guarantee in respect of a bank loan made to Company E when S set up the business. The companies are controlled by associated individuals but there is no financial (or other) link between the two companies because the guarantee has been given by R in a personal capacity and this financial support has no link to Company D - the companies are therefore not associated. If, however, the loan to Company E was made direct from Company D or R had given additional security over the assets of Company D in support of his loan, there would be a financial link between the two businesses, either directly or indirectly, which would cause the companies to be "associated".

L is the major shareholder and director of Company M, a large road haulage company. His son P is the sole shareholder in Company Q, a furniture business, which P has built up from scratch and runs with his wife. The premises occupied by Company Q are owned by L but Company Q pays a market rent for them. The two companies are controlled by associated individuals but there is no financial (or other) link between the companies. L has never had any involvement

with Company Q and P has never had any involvement in Company M. Since there are no financial links, beyond a simple rental of premises on market terms, the companies are not interdependent and therefore not “associated companies”.

Some years ago Mr X started a taxi business, Company T, using money loaned to him by his wife Mrs X, secured against the assets of her property rental business, Company U. Company T was successful and over time paid off the loan in full. Neither Mr X nor Mrs X now has any involvement in the other’s business and similarly the two companies have no links to one another. In the absence of any links between the two companies, whether financial, economic or organisational, Mrs X and Company U’s historic link with Company T is not relevant and the two companies are not associated.

On retiring, Mr F sold his farming business to his son’s G and H. The two sons raised the money to buy their father’s farm through a joint loan from the bank secured against the assets of the business. On taking over the farm they split it into two companies one of which was owned by G and the other by H. Both companies undertake similar, albeit not identical activities, using substantially common facilities, staff and equipment. While the two companies are separately owned, the level of financial, economic and organisational interdependence between G and H and their companies mean that their two companies are associated.

Mr J owned a newsagents Company T and a joinery business, Company U. On retirement Mr J’s son bought all J’s shares in Company T and Mr J’s daughter bought all J’s shares in Company U. Neither J’s son nor daughter has any involvement in the other’s company and the companies themselves have no economic, financial or organisational links. Notwithstanding Mr J’s previous ownership of both, company T and company U are not associated

CTM03790 - Interdependence – economic interdependence

SI 2011 xxxx paragraph 4

Two companies are economically interdependent if (in particular):

- the companies seek to realise the same economic objective or
- the activities of one benefit the other or
- the companies have common customers

Examples

A and B are brothers who have built up successful internet businesses from modest beginnings when sharing a flat together as students. Right from the start both were interested in the business possibilities of web site design. A is the major shareholder and director of Company P which provides professional web design services, and B is the major director and shareholder of Company Q which provides graphic design services. Although their developing businesses benefited from the mutual exchange of ideas, especially in the early days, the brothers have had no other involvement in each other’s businesses, which operate entirely independently. The economic links between the two companies are too tenuous to associate them.

C is the major shareholder in Company Y and a 49 per cent shareholder in Company Z. The two companies operate a large public house, which is popular for family dining as well as having a thriving wet trade. Company Y handles wet sales and Company Z, which is run by the majority shareholder, C’s wife, manages the catering operation. Mrs C has financed the purchase of the assets of the catering business from a family legacy and a loan to Company Z which she is guaranteeing personally. Both businesses are insured separately. Each business fully meets its own costs, and the catering business is charged a commercial rate for the use of the shared premises, employees and facilities. Although there is no cross subsidy, the two companies share

a common economic goal with a common customer base and mutually beneficial activities. In addition, the two companies are organisationally interdependent, sharing premises and employees. The two companies are accordingly associated.

Mr Q is the major shareholder in Company C which runs a large Chinese restaurant. It also operates a Chinese supermarket backed by its reputation as a restaurant. Mrs Q, who is a chef trained in France, is the sole shareholder in Company D which runs a gastronomically starred restaurant she has built up from scratch. Company D also imports delicacies from all over the world for sale on the internet, again backed by its reputation as a restaurant. Although Q and Mrs Q are husband and wife and in the same trade, there is no link between their companies, which have been trading since well before they knew each other. They are not associated.

M is the major shareholder in Company R, a dry cleaning business. Mrs M has opened a second dry cleaning business in the same town. This is run by Company S, of which she is the sole shareholder. Company S offers specialist services in relation to wedding and evening dresses in addition to the normal range of dry cleaning facilities. Company R acts as agent for these specialist services which it does not have the ability to supply itself. Company S and Company R share the same basic economic objective and their activities are of mutual benefit. The companies are therefore associated.

X is the director and sole shareholder of Company R which operates a chain of shoe shops. His wife also runs a shoe shop through Company S. Although the two companies are in the same line of business, there are no links between them and they operate entirely independently. Mr X and Mrs X started their individual businesses long before they met and they have kept the two enterprises entirely separate. The two companies are operated by associated individuals but there is no link between them, they are not associated.

CTM03795 - Interdependence – organisational interdependence

SI 2011 xxxx paragraph 5

Two companies are organisationally interdependent if (in particular) the businesses of the companies have or use:

- common management
- common employees
- common premises
- common equipment.

Examples

Mr and Mrs B each run their separate companies from their family home which is owned by Mrs B. Mr B's company could not afford to buy or rent other accommodation to trade from. Apart from sharing the family home and the family's domestic 'phone line for occasional business calls and internet access there are no other financial, economic or organisational links between the two companies. Although Mr B's company could not survive organisationally or financially without use of the family home, there is no direct or indirect financial support from either his wife or his wife's company to either him or his company, and no organisational links which amount to substantial interdependence.

Y is the director and sole shareholder of Company A and Mrs Y is the major shareholder in Company B. The two companies operate a chain of hairdressing salons. Company A provides hairdressing services and Company B provides hairdressing products. Company A rents the premises, employs the stylists and receptionists and pays all the bills. There is no cross charge for

the use of facilities. Credit card payments are accepted by the salons, the electronic swipe machines being in the name of Company A. There is a single bank account to which the swipe machines are attached. At the end of each day the bankings are split between the two companies and transferred to their main bank current accounts. The accounts of the two companies do not truly reflect the situation of the businesses but are just an artificial division. In reality the two companies are part of a single organisation – there is just the one business.

Z is the director and sole shareholder of Company P. He and his son are directors of Company Q, and own 50 per cent of the shares each. Companies P and Q run a builders' yard selling wholesale to the building trade and retail to the public from the same premises, which Z owns. Company P is the trade wholesaler and has a 'trade only' counter; Company Q sells retail at a counter with its own access and parking in the yard. Company P's buyer buys stock for both the wholesale and retail side but the product ranges, stocking levels and prices are different. There are separate 'phone lines for the wholesaler and retailer. Z charges Company P a commercial rental. At the end of each week Company P invoices Company Q for goods supplied at cost plus a small mark-up. There is a proportionate division of overhead costs and Company P invoices Q an additional charge for other facilities. Wages for common employees are split in proportion between the two businesses. There are separate sale terms and tills for the businesses and they operate separate bank accounts and credit and credit card facilities. Each business has its own vehicles and the costs are kept strictly separate.

Where several business activities are operated from the same or adjoining premises, and the existence of one underpins the viability of the other, the companies will be interdependent. While the two companies may operate at arms length, there are significant organisational and economic links such that the retail business could not operate without the wholesale side. Accordingly, the companies will be associated.

CTM03800 – Commercial interdependence – what HMRC do not consider to be substantial commercial interdependence

In determining "control" for the purposes of ICTA88/s13(4), the attribution of rights held by associates is not intended to apply where there is an "accident of circumstance" but rather on whether there is, in a real sense, interdependence between the parties .

Each case will depend on its specific circumstances but there is no substantial interdependence in situations where links between companies consist solely of an accident of circumstance as it would be disproportionate to see this as evidence of interdependence.

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