

Change 616: Small companies' relief: relaxations in the test for being an associated company: clauses 5 and 7 to 9

This change enacts parts of ESC C9.

Under section 13(4) of ICTA two companies are associated, for the purpose of small companies' relief, if one has control of the other, or if both are under the control of another company. "Control" is construed in accordance with section 416 of ICTA.

ESC C9 has four main parts, set out in paragraphs 2, 3, 4 and 5 of the concession.

Paragraph 2: Fixed-rate preference shares

Under section 416(2) of ICTA a company controls another if it possesses the greater part of its share capital. Share capital includes preference shares.

So a lending company providing finance to a borrowing company by way of preference shares may technically control the borrowing company with the result that the two companies are associated. Furthermore, all borrowing companies controlled in this way by the lender are associated with each other.

By concession, some holdings of fixed-rate preference shares are ignored for the purpose of determining control for the purposes of small companies' relief. The concession applies if the holding of fixed-rate preference shares is the only reason for two companies to be treated as associated.

Clause 7 enacts this part of the concession.

Paragraph 3: Loan creditors

Under section 416(2) a company controls another if it possesses such rights as would entitle it to the greater part of the assets of the other company. A loan creditor may have such rights.

So a loan creditor may technically control the borrowing company with the result that the two companies are associated. Furthermore, all borrowing companies controlled in this way by the lender are associated with each other.

By concession loans made between companies that are otherwise completely unconnected are ignored if the loan creditor is not a close company. And there is a similar concession if unconnected companies are controlled by a common loan creditor.

Clause 8 enacts this part of the concession.

The concession ignores a “bona fide commercial loan creditor”. Such a creditor is not a “loan creditor” for the purposes of the clause because subsection (4) applies the exclusion in section 417(9) of ICTA.

Paragraph 4: Trustee companies

Under section 416(1) of ICTA a company is associated with another if one controls the other.

ICTA does not specifically exclude control which is established by rights and powers held on trust. By concession, such rights and powers are ignored.

Clause 9 enacts this part of the concession.

Paragraph 5: Relatives

Section 417(3) and (4) of ICTA defines “associate” to include a relative. By concession, in some circumstances, HMRC restrict the definition of “relative” to a husband, wife or minor child. This part of the concession depends on there being “no substantial interdependence” between the companies concerned. This test forms part of the review of the associated companies rules, announced by the Chancellor in his Autumn 2007 Statement on Tax Simplification Reviews. For the moment this Change does not propose legislation of paragraph 5 of the concession.

Capital allowances

It is not clear from the words of the concession whether or not it applies also for the purpose of section 99 of CAA (monetary limit for long-life assets). In practice the concession is applied for the purpose of section 99 of CAA so that the treatment in clauses 7 to 9 applies also to the monetary limit for long-life assets.

This change is in taxpayers’ favour in principle. But it is expected to have no practical effect as it is in line with generally accepted practice.