

Part 1

Chapter 1: Relief for small companies

Overview

1. The profits of “small companies” are charged to tax at a lower rate than the main corporation tax rate. For this purpose, the size of a company is determined by reference to the amount of its profits.
2. A lower rate is used if the company’s profits (for a full year) are less than the “upper limit”. In making this comparison, there may be two adjustments.
3. First, some franked investment income is added to the profits of the company.
4. Second, the amount of the “upper limit” is split between companies that are under common control.

Clause 1: Overview of Chapter

5. This clause introduces the Chapter. It is new.

Clause 2: Profits charged at the small companies’ rate

6. This clause sets out the three conditions for the small companies’ rate to apply. It is based on section 13(1) of ICTA.
7. The first condition is that the company is resident in the United Kingdom *in* the accounting period. If a company becomes, or ceases to be, resident in the United Kingdom an accounting period ends (see the rules about accounting periods in section 12 of ICTA, to be rewritten in Bill 5). So the effect of this condition is that the company must be resident in the United Kingdom *throughout* the accounting period.
8. The second condition is that the company is not a “close investment-holding company”. That expression is defined in clause 12.
9. The third condition is that the “augmented profits” (defined in clause 10) of the company do not exceed the small companies’ rate limit. If the profits fall between that limit and the upper limit, marginal relief may be due in accordance with clause 3.
10. This clause does not include a requirement that the company should make a claim for the relief. See *Change 614* in Annex 1.

Q1. We welcome comments on the proposal to drop the requirement for a claim for small companies’ relief.

Clause 3: Marginal small companies’ relief

11. This clause sets out the rules for marginal relief. It is based on section 13(2) of ICTA.

12. As with the entitlement to the small companies' rate, there are three conditions for the relief. There is no difference in the first two (see paragraphs 7 and 8). But for the purposes of this relief the third condition is that the "augmented profits" (defined in clause 10) of the company fall between:

- the "small companies' rate limit" (in ICTA, the "lower relevant maximum amount"); and
- the "upper limit" (in ICTA, the "upper relevant maximum amount").

13. The limits are set out in clause 4.

14. This clause does not include a requirement that the company should make a claim for the relief. See *Change 614* in Annex 1.

Q2. We welcome comments on the proposal to drop the requirement for a claim for marginal small companies' relief.

Clause 4: The small companies' rate limit and the upper limit

15. This clause sets the limits for small companies' relief. It is based on section 13(3) of ICTA.

16. *Subsection (1)* deals with the straightforward case where there are no associated companies.

17. *Subsections (2) to (4)* deal with the case where there are associated companies. The limits are divided equally between the companies.

18. *Subsection (5)* reduces the limits if the company's accounting period is less than twelve months long.

Clause 5: Associated companies

19. This clause defines "associated company" for the purpose of clause 4. It is based on section 13(4) and (5) of ICTA.

20. *Subsection (1)* sets out the position if a company is an associated company for any part of an accounting period. It counts as an associated company for the whole of the accounting period.

21. *Subsection (2)* clarifies the position if more than one company is an associated company for different parts of an accounting period.

Example

Company A claims small companies' relief for its accounting period from 1 January 2009 to 31 December 2009.

A is associated with B in the period 1 January 2009 to 31 March 2009.

A is associated with C in the period 1 October 2009 to 31 December 2009.

A has two associated companies in its accounting period ending on 31 December 2009, even though it never has more than one at any time.

22. *Subsection (3)* is the rule that associated companies that carry on no business are ignored. The rule is modified by subsection (6).

23. *Subsection (4)* is the main rule for determining whether or not companies are “associated”, based on “control”. The rule is modified by subsection (6).

24. *Subsection (5)* defines “control” for the purpose of subsection (4). The definition is based on section 416 of ICTA but is modified by subsection (6).

25. *Subsection (6)* introduces the special rules for associated companies in the next four clauses.

Clause 6: Section 5(3): treatment of certain holding companies

26. This clause is the rule that passive holding companies are ignored as associated companies. It is new. See *Change 615* in Annex 1.

Q3. We welcome comments on the proposal to enact SP5/94.

27. *Subsection (1)* sets out the three conditions for the treatment in the clause. The first two conditions reproduce the main words of SP5/94. The third condition introduces the concept of a “passive holding company”, defined in subsection (3).

28. *Subsection (2)* is the result if the conditions are met: the company is treated as being within clause 5(3) and is ignored for the purposes of claims for small companies’ relief by any company with which it is associated.

29. *Subsection (3)* reproduces the conditions in SP5/94 for a company to qualify as a passive holding company. See *Change 615* in Annex 1 for a fuller discussion of the conditions.

30. *Subsection (4)* sets out the condition that any dividends received from subsidiaries are distributed in full by the holding company.

31. *Subsection (5)* makes clear that this clause and clause 5 are alternatives. So a company that does not meet the conditions in subsection (1) (perhaps because it has no subsidiaries or has assets in addition to shares in subsidiaries) may still qualify to be ignored as an associated company by virtue of clause 5(3).

Clause 7: Associated companies: fixed-rate preference shares

32. This clause is the rule that some fixed-rate preference shares are ignored in determining whether one company controls another. It is new. See *Change 616* in Annex 1.

Q4. We welcome comments on the proposal to enact paragraph 2 of ESC C9.

33. *Subsection (1)* sets out the three conditions for the special treatment. The second condition includes a reference to the company which holds the shares taking part in the management or conduct of the issuing company’s business. It is unlikely that a company (rather than an individual) would do this but the clause retains this part of the condition for the relaxation to apply.

34. *Subsection (2)* sets out a definition of “fixed-rate preference shares”. The concession refers to the definition in Schedule 28B to ICTA, which deals with venture capital trusts. The definition here is the rewritten version in section 313(7) of ITA 2007.

Clause 8: Association through a loan creditor

35. This clause is the rule that some loan creditors are ignored in determining whether one company controls another. It is new. See *Change 616* in Annex 1.

Q5. We welcome comments on the proposal to enact paragraph 3 of ESC C9.

36. *Subsection (1)* deals with the simple case of a loan creditor which would otherwise be associated with the company to which it has lent money. The subsection sets out the two conditions that have to be met if the loan creditor is to be ignored. The first condition (“no connection”) is amplified in subsection (5).

37. *Subsections (2) and (3)* deal with the more complex case of two companies which would otherwise be associated with each other because they are controlled by the same loan creditor. The condition in subsection (2)(b) is amplified in subsection (5).

38. *Subsection (4)* imports the definition of “loan creditor” from section 417 of ICTA. Section 417(9) of ICTA prevents a bank from being treated as a loan creditor just because of an ordinary bank loan. So this clause reproduces the additional concession in ESC C9 that applies to a loan creditor which is a “bona fide commercial loan creditor”.

39. *Subsection (5)* sets out the condition in the ESC that there is “no past or present connection” between the company and the loan creditor. It reflects the strict interpretation that is used in practice in applying the concession.

40. *Subsection (6)* defines “control” for the purpose of subsections (2) and (3). The definition is based on section 416 of ICTA but is modified by subsection (1) of this clause (to eliminate some loan creditors) and clauses 7 (to eliminate some fixed-rate preference shares) and 9 (to eliminate some trustee companies).

Clause 9: Association through a trustee

41. This clause is the rule that some holdings of trustee companies are ignored in determining whether one company controls another. It is new. See *Change 616* in Annex 1.

Q6. We welcome comments on the proposal to enact paragraph 4 of ESC C9.

42. *Subsections (1) and (2)* deal with the simple case of a trustee company which would otherwise be associated with the company in which it has rights (or over which it has powers). The rights or powers are to be ignored. But this treatment applies only if there is no other connection between the companies (see subsection (5)).

43. *Subsections (3) and (4)* deal with the more complex case of two companies which would otherwise be associated with each other because they are controlled by the same trustee company. As in subsections (1) and (2), the rights or powers of the trustee company are to be ignored. This treatment also applies only if there is no other connection between the companies (see subsection (5)).

44. *Subsection (5)* sets out the condition in the ESC that there is “no past or present connection” between the company and the trustee company. It reflects the strict interpretation that is used in practice in applying the concession.

Clause 10: Meaning of “augmented profits” in this Chapter

45. This clause defines the augmented profits which are compared with the limits in clauses 3 and 4 to determine whether or not small companies’ relief is due. It is based on section 13(7) of ICTA.

46. In section 13 of ICTA the word “profits” is used in a special sense to mean the total of what are usually referred to as profits and some franked investment income. This may lead to confusion. So this clause uses “net profits” [not defined in this print] to mean the amount on which corporation tax is charged and introduces a new term “augmented profits” which is used only in this Chapter.

47. *Subsection (1)* is the basic definition of “augmented profits”. In determining whether a company is “small” for the purposes of this Part, dividends received are taken into account, even though those dividends are not charged to corporation tax.

48. *Subsection (2)* excludes what is usually known as “group income”. This comprises:

- distributions from companies in the same group as the receiving company; and
- distributions from trading companies (“quasi-subidiaries” – defined in subsection (3)) which are owned by a consortium of which the receiving company is a member.

49. The meanings of “trading company” and “relevant holding company” in subsection (2)(b) are set out in clause 11(4).

Clause 11: Interpretation of section 10(2) and (3)

50. This clause expands the meaning of “51% subsidiary”. It is based on section 13ZA of ICTA.

51. *Subsection (1)* is similar to the group relief rule (see clause 55, published with committee paper CC/SC (07) 27). It ensures that the tax relationship between companies is not based simply on share-holding if the share-holding does not represent the true economic relationship. So the subsection looks also at the equity holders’ entitlement to profits and assets. “Equity holders” are defined in subsection (7) by reference to the group relief rules (see Chapter 6 of the group relief Part, published with committee paper CC/SC (07) 27).

52. *Subsection (2)* makes clear that the basic tests for being a 51% subsidiary in section 838 of ICTA still apply.

53. *Subsection (3)* is similar to the group relief rule (see clause 55, published with committee paper CC/SC (07) 27). Shares held by a share dealer are ignored.

54. *Subsection (4)* provides the meaning of trading company for the quasi-subidiaries in clause 10(2)(b).

55. *Subsections (5) and (6)* are similar to the group relief rule (see clause 57, published with committee paper CC/SC (07) 27). But subsection (5)(b) and (c) includes an economic test for the 5% ownership requirement in a consortium.

Clause 12: Close investment-holding companies

56. This clause defines the close investment-holding companies which are excluded from small companies’ relief by clauses 2(b) and 3(1)(b). It is based on section 13A of ICTA.

57. The rule about close investment-holding companies is an anti-avoidance rule. Without it, a wealthy individual could transfer investments to a company where undistributed income would bear tax at a rate lower than the individual’s marginal rate.

58. The clause uses the expression “candidate company” to describe the company which is being considered to determine whether or not it is a close investment-holding company.

59. *Subsection (1)* defines close investment-holding companies by exclusion. All close companies are close investment-holding companies unless they exist for “permitted purposes”.

60. *Subsection (2)* sets out the permitted purposes. The first two purposes (paragraphs (a) and (b)) are concerned with the activities (broadly, trades and property businesses) of the candidate company itself. The last four purposes (paragraphs (c) to (f)) allow a candidate company to qualify as having a permitted purpose by reference to “qualifying companies” (and some others) with which it is closely connected.

61. *Subsection (3)* excludes from the property businesses in subsection (2)(b) letting to individuals who have a close connection with the candidate company.

62. *Subsection (4)* extends the purpose in subsection (2)(c) so that it covers not only investment in a qualifying company but also investment in another company which itself invests in a qualifying company.

63. *Subsection (5)* defines “qualifying company” by reference to the same purposes of trades and property businesses as apply to the candidate company in subsection (2)(a) and (b).

64. *Subsection (6)* ensures that a company which exists for a permitted purpose does not become a close investment-holding company simply because it is wound up. But this special treatment lasts only for one accounting period.

65. *Subsection (7)* provides two definitions for the clause. In this clause some permitted purposes depend on control of the candidate company. ESC C9 would operate against taxpayer companies in this context and so does not apply. It follows that the relaxations in clauses 7 to 9 do not apply here and the meaning of “control” is different from that in clause 5(4).