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Changes to 51% group companies and associated companies' rules

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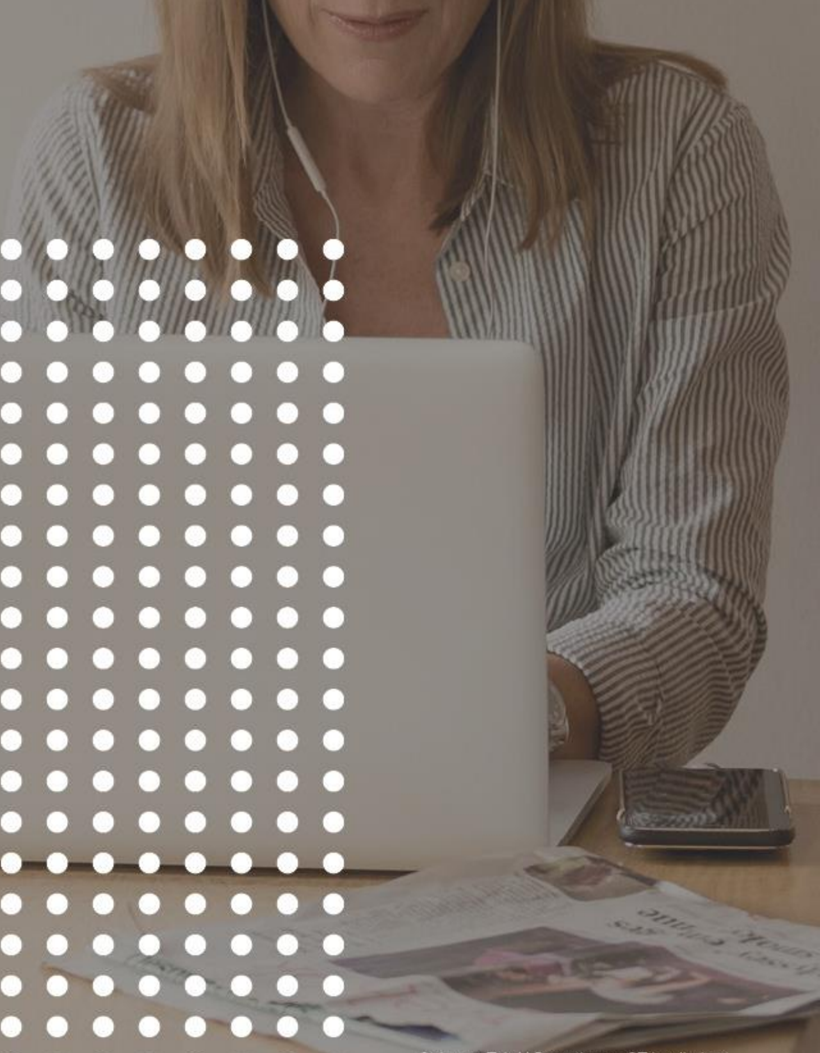

Changes to 51% group companies and associated companies' rules

Background

As well as the increase in corporation tax rate from 19% to 25%, the Finance Act 2021 (FA 2021) outlined a change in the rules for determining related 51% group companies. From 1 April 2023, the current rules will be replaced by the new associated companies' provisions. However, these rules may not be entirely unfamiliar, as they were the rules before they were repealed in April 2015.

What has changed?

Currently, a company and its '51% related group companies' includes the following situations:

- Company A is a 51% subsidiary of Company B;
- Company B is a 51% subsidiary of Company A; and
- Company A and Company B are both subsidiaries of the same company.

A company is deemed a 51% subsidiary when more than 50% of the ordinary share capital is owned directly or indirectly.

However, from 1 April 2023, a group will no longer consist of a company and its 51% related group companies, but instead its associated companies. A company will be associated with another (including overseas companies) where:

- One of them has control of the other; or
- Both are under the control of the same person or persons (including individuals).

'Control' for these purposes, means having or being entitled to, the greater part (i.e. 51% and over) of the share capital, voting power and/or distribution rights. However, there may be exceptions to consider where preference shares exist, or shares are held in trust.

Scenario

Say, for example, Mr X owns 100% of the share capital in three single companies. Under the current 51% related companies' provisions, the companies are not related. However, under the new associated companies' rules the three companies will become associated, as Mr X has control of each of the companies.

Direct and indirect ownership

When considering control at an individual level, it is important to consider both the direct and indirect rights of ownership. Direct rights are shareholdings held directly by individuals. Indirect rights are shares held by their Associates (i.e. spouses/civil partners, blood relatives, business partners etc.). It is therefore possible that an individual can be deemed to control another company by virtue of a family member's shareholding in that company – meaning that both companies are considered associated for corporation tax purposes.

However, where there is no substantial commercial interdependence between companies, the indirect rights of an individual should not be considered. In these circumstances, the only companies that will be treated as being associated are the companies under the direct control of the same individual or group of individuals. For reference, 'substantial commercial interdependence' relates to companies' financial, economic, and organisational links. For example, if they:

- perform the same trade
- exist to supply each other
- share premises
- provide financial support by lending money, or
- have a financial interest in the same business etc.

It should also be noted that dormant companies will not be included; overseas companies, on the other hand, are not excluded.

How will this affect you and your companies?

The changes in the above rules will have an effect on the following areas:

- **Marginal Relief** – From 1 April 2023, the rate of corporation tax is set to increase to 25% for all companies where profits exceed £250k. Companies with profits of less than £50k will continue to be taxed at 19%, and a tapered rate will apply to companies with profits between these limits. The upper and lower limits will be reduced proportionately for the number of associated companies, meaning that the more associated companies, a company the lower the 25% threshold. For example, a company with two other associates will pay 25% tax on taxable profits over £83,333 (£250k/3).

- **Quarterly Instalment Payments (QIPs)** – The QIPs threshold (i.e. £1.5m and £20m for large and very large companies, respectively) must be divided by the number of companies in the group. For accounting periods beginning on or after 1 April 2023, the number of companies in the group will be determined by the new associated companies' rules and may bring in more companies than under the previous rules.

- **Long Life Plant and Machinery** – Plant with a useful life of more than 25 years will usually attract capital allowances written down allowances of 6%. However, where expenditure does not exceed £100k, the plant is excluded from these rules. The de-minimis £100k threshold is currently apportioned over the number of related 51% group companies. From 1 April 2023, this will change to the number of associated companies.

- **Patent Box** – Where the profit of each trade does not exceed £1m, a 'small claim' can be made. Again, the £1m threshold is currently apportioned over the number of related 51% group companies. From 1 April 2023, this will change to the number of associated companies.

Is Group Relief affected?

In short, the rules relating to group relief will not change. This is on the basis that 'a group' for group relief purposes is defined differently: as a company and its 75% subsidiaries. Unfortunately, this means that whilst companies may be considered associated for the purposes of the issues raised above, they will not be able to level out any corporation tax liabilities by claiming group relief unless the 75% test is met.

Do you need anything now?

You should consider these rules as part of your company's tax planning activities well in advance of 1 April 2023. Now is the time to consider:

- The number of associated companies under the new rules to determine the level and timing of corporation tax payable.
- Can any taxable profits be accelerated such that they fall within the 19% rate (e.g. planned disposals of properties or investments with large gains)?
- Is there an alternative structure for the associated companies that may be more tax efficient after 1 April 2023?
- Will my company be required to pay QIPs under the new rules, and will this impact on cashflow?

We're happy to assist with any queries you have about these changes. Please feel free to contact us using one of the methods below.

Need more help?

Please contact John Rodger, Corporate Tax Partner at john.rodger@ct.me or Claire Howie, Corporate Tax Manager at claire.howie@ct.me

- Information correct at July 2022.

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