Let's form a group

JONATHAN COLETTA explains the various definitions of a group, which will be important for students of ATT Paper 4.

Groups are an important part of ATT Paper 4. In fact, although I am not on intimate terms with the examiners, I would say that a long question from them is almost guaranteed in the real exam, not to mention short form questions (SFQs). Unless students are prepared to forfeit 20 or more marks this is an area with which they need to be very familiar.

So, what's the problem? Well, there are four different definitions of a group and the one required will depend on the rule in question, thus it is necessary to learn thoroughly the basic definitions. The fine details could also be tested (particularly as an SFQ) and should be highlighted in the student's copy of the legislation.

The four group definitions apply to:

1. related companies;
2. loss groups;
3. consortia; and
4. gains groups

1. Related companies

The relevance of the related companies rules is in deciding when a company must pay its corporation tax. Will it be payable under the quarterly instalment regime or will the whole amount become due nine months and one day from the end of the accounting period? If augmented profits (taxable total profits (TTP) plus dividends, but excluding dividends from subsidiaries – yes, yet another definition) exceed £1.5m the company usually has to pay in instalments.

KEY POINTS

- Understanding the relationships of companies within a group is important to maximising exam marks.
- Understanding whether companies are related will enable the corporation tax payment dates to be determined.
- Companies owning at least 75% of others can surrender certain losses within the group.
- Consortium companies can also surrender losses, but restrictions apply.
- For a gains group, a company must be an immediate 75% subsidiary, but the effective interest can be less.

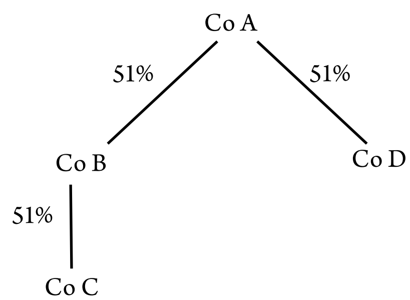
Here, the £1.5m limit is divided by the number of related companies. CTA 2010, s 279F explains:

> 'A company ("B") is a related 51% group company of another company ("A") if for any part of the accounting period:
> (a) A is a 51% subsidiary of B;
> (b) B is a 51% subsidiary of A; or
> (c) both A and B are 51% subsidiaries of the same company.'

Note that related 51% group companies include worldwide companies, but exclude those that are inactive and passive holding companies.

Diagram A illustrates what this means in practice.

Diagram A



When looking at 51% (strictly more than 50%) shareholdings we must take account of effective interest of one company in another. Therefore, in ***Diagram A***, several points should be noted.

- Co A is related to Co B and Co D so we will divide its limit by three companies. If any of these companies has augmented profits of more than £500,000 corporation tax will be payable by instalments.

- Co D is also related to Co A and Co B so has the same limit.
- Co B is also related to Co C therefore the £1.5m limit must be divided by four.
- Co C is related to Co B only; therefore the £1.5m limit must be divided by two.
- Co C is not related to Co A or Co D because the effective interest of Co A in Co C is only 26% (51% x 51%).

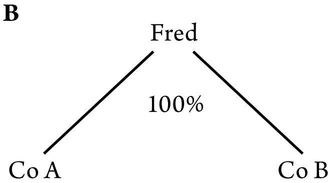
Bear in mind that we are carrying out this exercise merely to ascertain whether the companies will pay corporation tax in instalments or nine months and a day from the end of the accounting period.

When determining whether the limit is divisible, we take account of only those companies that are in the group at the end of the previous accounting period. So let's say that Co A has owned 100% of Co B for many years but, during the year ended 31 March 2018, it acquires 100% of Co C.

As at 31 March 2017 there are two companies in the group (Co A and Co B) so they will divide £1.5m by two when considering their augmented profits for the year ended 31 March 2018.

Note also that we consider only 'corporate' groups here. The £1.5m limit is not divisible in circumstances where companies are under common personal ownership, as illustrated by ***Diagram B***.

Diagram B

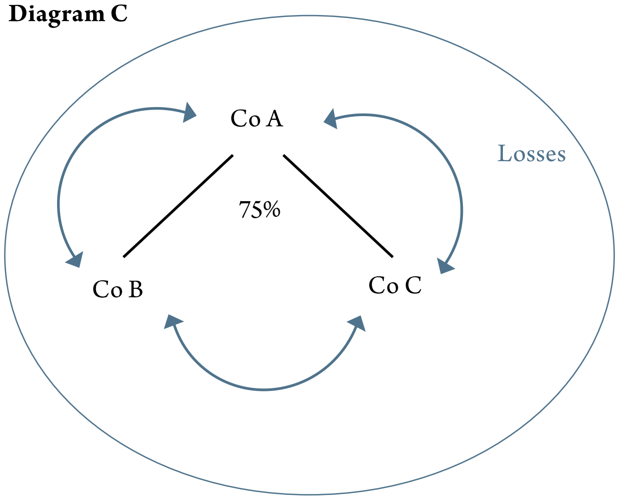


In ***Diagram B***, although Co A and Co B are both owned by Fred, the 100% shareholder, they are not related and each has a £1.5m limit to determine when corporation tax is payable.

2. Loss groups

Companies that are entitled to group relief can surrender specific losses around the group (see CTA 2010, Pt 5 ch 2 and ch 3). Here, 75% ownership or more is required (CTA 2010, s 151, s 152, s 1154). However, the effective interest must also be at least 75%, as shown in ***Diagram C***.

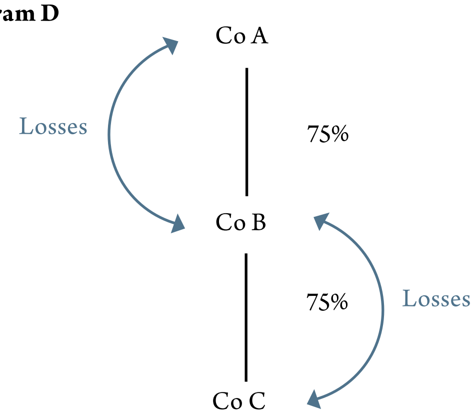
Diagram C



In the ***Diagram C*** group, losses can be surrendered in any direction using group relief. The two main losses that can be surrendered under the group relief rules are trade losses and non-trade loan relationship deficits. There are other more obscure reliefs, but note that companies cannot surrender capital losses under these rules.

In a 'vertical' group, such as in ***Diagram D***, matters become more complicated:

Diagram D



In the vertical group:

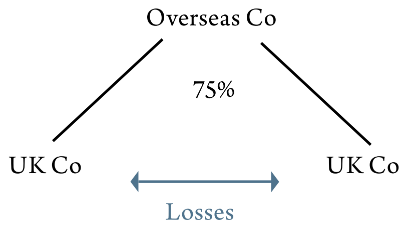
- Co A can surrender to Co B and vice versa;
- Co B can surrender to Co C and vice versa; but

- Co A cannot surrender to Co C because the effective interest is only 56.25% (75% x 75%).

So in ***Diagram D*** we have two loss groups, although it will depend on the percentages involved. If the companies were both 90% subsidiaries, Co A could surrender to Co C because the effective interest would then be 81% (90% x 90%).

Again we are looking solely at corporate groups. As illustrated by ***Diagram E***, overseas companies can be used to 'form' the group, but losses cannot be surrendered to or from them because, for these purposes, they are not members of the group.

Diagram E



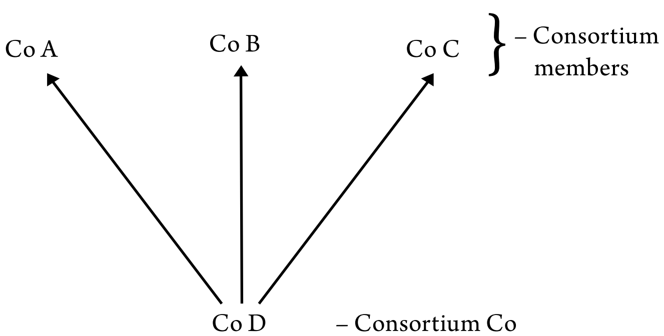
3. Consortia

In a consortium (such as in ***Diagram F***) there will again be the ability to surrender losses, but there are restrictions on the amounts that can be surrendered. CTA 2010, s 153(1) and s 153(2) state:

> '(1) For the purposes of this Part a company is owned by a consortium if:
> '(a) the company is not a 75% subsidiary of any company; and
> '(b) at least 75% of the company's ordinary share capital is beneficially owned by other companies, each of which beneficially owns at least 5% of that capital.
> '(2) The other companies each owning at least 5% of the share capital are the members of the consortium for the purposes of this Part.'

So we could paraphrase this by saying that a consortium exists if 75% of the shares of the company (the consortium company) are owned by other companies (the consortium members). Each consortium member must own 5% or more of the consortium company.

Diagram F



The losses can only be surrendered up to and down from the consortium company, Co D. Losses cannot be surrendered between Co A, Co B and Co C, the consortium members.

As before, the loss surrender rules apply only to corporate arrangements and, as illustrated by ***Diagram G***, although an overseas company can be used to 'form' the consortium, losses cannot be surrendered to or from such a company.

Diagram G

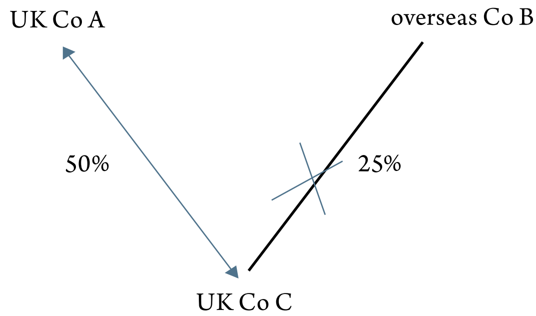
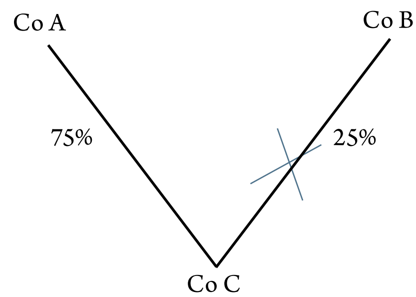


Diagram H illustrates another important point: a group and a consortium cannot co-exist. This makes life easier because as soon as one company has an interest of 75% or more we can forget about the consortium rules.

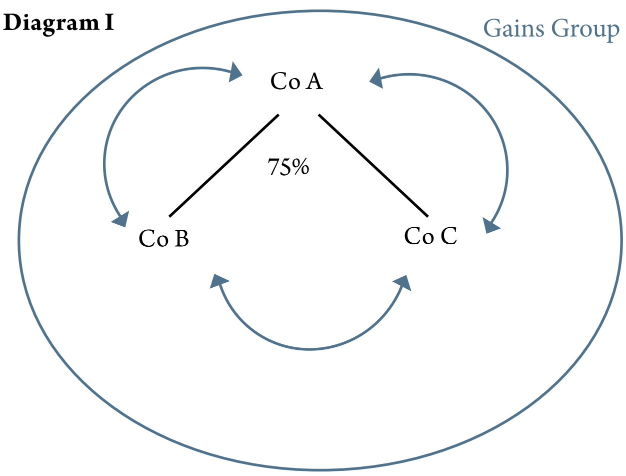
Diagram H



4. Gains groups

Finally, we come to our last group definition, the gains group (TCGA 1992, s 170). Here, a subtly different definition is used compared with that when dealing with group relief, so care is required.

Diagram I

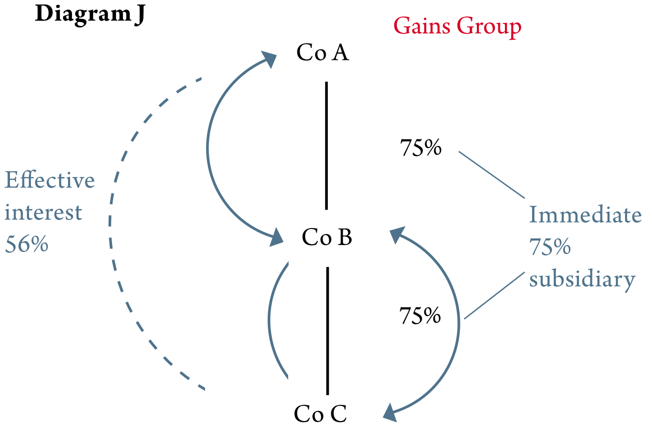


In such an arrangement the group company must be an immediate 75% subsidiary. However, the effective interest needs only to be more than 50% (TCGA 1992, s 170(7)).

In a 'flat' group, such as that shown in ***Diagram I***, the gains group looks identical to the losses group in ***Diagram C***.

As before, we only consider corporate groups. Thus, an overseas company can be used to form the group but it will not be a member of it. However, when we 'go vertical' – as in ***Diagram J*** – the differences between the gains group and that for group relief become apparent.

Diagram J



With the group in ***Diagram J***, Co A has an immediate 75% subsidiary (Co B) and the effective interest in Co C exceeds 50% (75% x 75% = 56%), so all three companies are in the same group. However, for losses (as illustrated by ***Diagram D***) we have two separate groups: Co A and Co B and then Co B and Co C.

There is a further twist: unlike the losses group, a company cannot belong to more than one gains group.

In ***Diagram K***, the effective interest of Co A in Co D is 42% (75% x 75% x 75%). Because this is less than 50%, Co D is not in the gains group with Co A, Co B and Co C.

Further, Co D cannot be in a gains group with Co C because we must always start at the top to decide which group a company is in.

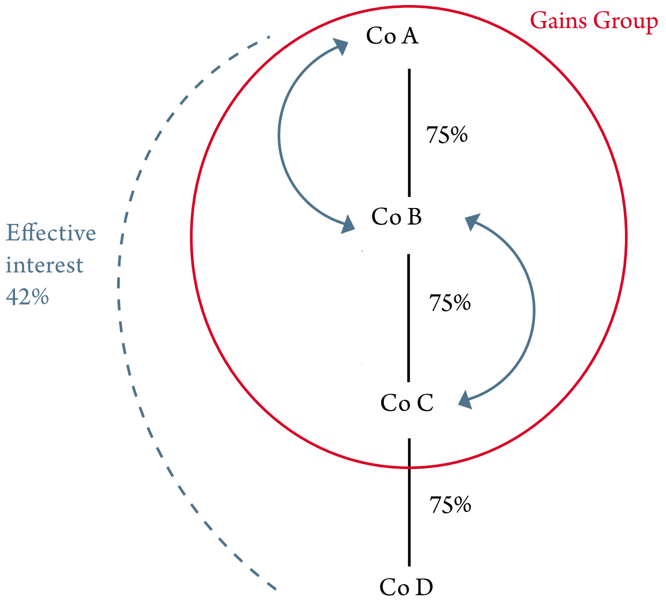
The three main effects of being in a gains group are:

(1) group-wide rollover relief;

(2) the ability to transfer assets at nil gain/nil loss within the group; and

(3) the surrender of chargeable gains and capital losses around the group.

Diagram K



On point 3 above, I said earlier that it is not possible to surrender capital losses. However, that was in the context of group relief when the losses are set against taxable total profits. When a capital loss is surrendered, this can be set against a chargeable gain only.

Conclusion

Tax students should now be able to look at complex company relationships and identify a loss group, consortium and gains group, not to mention related companies. The next problem is applying the rules, but that is another story…

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