The Personal Tax Planning Review

WHEN IS A GROUP NOT A GROUP?

Stephen Brandon, Barrister[1]

The purpose of this article is to muse on a simple little problem, which may occasionally arise. Suppose that the parent company of a group of companies ("Parent") wishes to establish a new company ("Newco") whose profits it, ultimately, wishes to take the benefit of. In the meantime, the profits from time to time arising in Newco are to accrue to the benefit of the employees. This is, of course, not an unknown way of benefitting employees and, since this is the *Personal Tax Planning Review*, I am, of course, particularly mindful of the needs of employees.

One point which may have been overlooked in implementing such a structure, is the need to secure that Newco obtains small companies' relief under Income and Corporation Taxes Act 1988 ("ICTA") s.13, that is to say that it is not "associated" with the rest of the group. Ah, you say, but if we secure *that*, all taxable supplies made between the group and Newco will be subject to Value Added Tax, and there may be problems with exempt supplies and thus the loss of input tax credits.

The answer to this dilemma is of course simple: create a Value Added Tax group, which structure does not result in Newco being "associated" with the rest of the group for the purposes of ICTA s.13. Simple.

Or perhaps not. Muse on the following. Companies are "associated" for the purposes of s.13 (4) if one of them has control of the other, or both are under the control of the same person or persons. In determining "control", the dreaded ICTA s.416 applies. S.416 (2) provides that a person shall be taken to have control of a company if he exercises, or is able to exercise or is entitled to acquire, direct or indirect control over the company's affairs, and in particular, if he possesses or is entitled to acquire:

> "(a) the greater part of the share capital or issued share capital of the company or of the voting power in the company..."

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1 Stephen Brandon BA LLM, 24 Old Buildings, Lincoln's Inn, London WC2A 3UJ
Tel: (071) 242 2744 Fax: (071) 831 8095
Author of *Foreign Companies and the Danger of UK Residence & Taxation of Non-Resident and Migrant Companies* both published by Key Haven Publications PLC.

I assume that, while our employees are "running the shop", they will hold the bulk of the rights to profits and to capital distributions at the time, including rights in a possible liquidation, and thus we need not concern ourselves with s.416 (2) (b) and (c).

S.416 (4) provides that, for the purposes of subsection (2), a person shall be treated as entitled to acquire anything which he *is* entitled to acquire at a future date, or *will* at a future date be entitled to acquire. Thus, we are lost if the group *is* entitled to acquire control or *will* become entitled to acquire control. Nothing is said about someone who *may* become so entitled, and it is common for effective control to pass under such arrangements, on the meeting of contingencies, at some future date.

Let us turn to Value Added Tax. Again, the question is whether companies are under the same control: Value Added Tax Act 1983 s.29 (3). For this purpose, however, the definition of "control" is stated by subsection (8) to be that set out in relation to a holding company and subsidiary company in Companies Act 1985. As the section in question (Companies Act 1985 s.736) has in fact been replaced by a new s.736 and s.736A (see Companies Act 1989 s.144) the reference to the Companies Act 1985 is to be taken as a reference to the newly inserted provisions: Interpretation Act 1978 s.20 (2). What does the new s.736 hold? Answer, that a company is a "subsidiary" of a "holding company" if the holding company:

> "(a) holds a majority of the voting rights in it, or
> (b) is a member of it and has the right to appoint or remove a majority of its board of directors, or
> (c) is a member of it and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in it..."

It will be appreciated that our only hope of circumnavigating the problem lies with subsection (b). Now, the power to appoint the majority of directors, if conferred on Parent, must give it power to control the company's affairs within ICTA s.416 (2). Ah, you say, let us rely on a right which only bites upon a future contingent event, since s.416 (3) cannot then apply. Unfortunately, however, the effect of Companies Act 1985 s.736A (4) is that one only considers such a right if the contingent circumstance has arisen.

Why not then consider s.736 (1)(b), together with s.736A (3), which lays down that, as regards the reference to appointing directors:

> "(b) a right to appoint...which is exercisable only with the consent or concurrence of another person shall be left out of account unless no other person has a right to appoint..."

Interesting drafting is it not? Assume Parent holds a nominal amount of the issued share capital of Newco. If such shares carry a right to appoint a director, and the employees have a right to block it, by virtue of holding their shares, the right of Parent is **not** ignored, if no other person has a right to appoint "in relation to that directorship".

Now we are left with an interesting time for the imaginative draftsman. Bearing in mind the need to isolate this particular "directorship" and to secure that no-one else has the power to appoint, Parent can be given a power which, in itself, does not confer any right which brings s.416(2) into play, yet the fact which renders that power useless (the blocking rights of the employees) is to be ignored.

In short, with careful drafting, it can be secured that a gap is found in the line between the two definitions. Just a thought!