

Connected companies and Employment Allowance: detailed technical guidance for employers and their agents

If you are a company, here is detailed technical guidance to help you decide if you are connected to other companies.

The rules relating to connected companies do not apply to unincorporated companies or single companies.

This guidance is relevant if a company has control of another company or both companies are under the control of the same person or persons. For example, companies linked in a group - these companies are connected.

The 'connected persons' rule for the Employment Allowance is largely based on the connected persons rule used more widely for tax purposes.

In order to operate the Employment Allowance from the beginning of the tax year the employer will need to know whether he is a connected person at the start of the tax year. If the test is satisfied at the start of the tax year, with 2 or more companies being connected at that point, the treatment for Employment Allowance purposes is set for the remainder of the tax year regardless of a subsequent change of circumstances in that year.

Exemptions from entitlement to claiming the Employment Allowance for connected companies

If, at the start of the tax year, 2 or more companies are connected with each other and those companies would otherwise each be entitled to the Employment Allowance, only one of those companies can qualify for the Employment Allowance for that tax year. It is up to the companies concerned to decide which one of them will qualify for the Employment Allowance.

The rules in place for determining if companies are connected are similar to the 'associated companies' rules at sections 25 and 27 to 30 of the Corporation Tax Act 2010.

Where 2 companies are only connected with each other through the attribution of rights between certain associated persons (eg relatives), the connected persons rule will only apply if the companies in question are substantially commercially interdependent. For example, when one company gives financial support to another, they have the same economic or commercial objectives and have common management, employees and premises.

How do I decide if I my company is connected to another company?

The basic rule for determining if two companies are 'connected' with each other is that they will be connected if one of them has control of the other or if both are under the control of the same person or persons. The term 'control' is given the same meaning as in sections 450 and 451 of the Corporation Tax Act 2010. This is where a person has or is entitled to acquire the greater part of the share capital or voting power in a company, or in the event of a distribution of the company's income the greater part of the amount distributed, or in the event of distribution of assets the greater part of the company's assets.

How is the application of control applied to Limited Liability Partnerships?

This test is modified in the case of a limited liability partnership so that control is where the other company possesses, or is entitled to acquire, rights to a share or more than half the assets or more than half the income of the limited liability partnership.

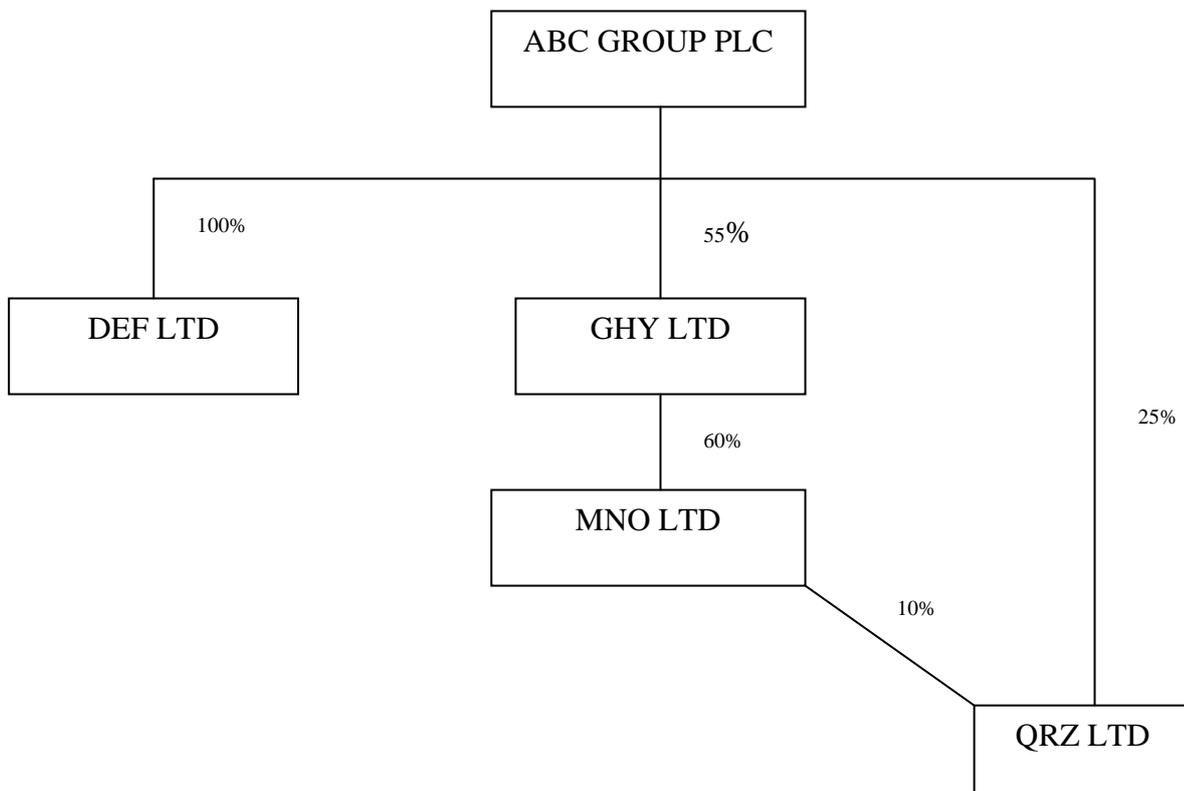
Features of control to be considered

These include:

- substantial commercial interdependence:
 - financial
 - economic
 - organisational
- fixed rate preference shares
- minimum controlling combination principle
- loan creditors
- trustees

Connections between companies

Example 1: control



At the start of the tax year, ABC Group Plc holds all of the issued share capital of DEF Ltd and 55% of the issued share capital of GHY Ltd. In addition, 60% of the share capital of MNO Ltd is owned by GHY Ltd. ABC Group Plc also has shares in another company, QRZ Ltd, totalling 25% of the issued share capital). A further 10% of the shares in MNO Ltd are held by QRZ Ltd.

ABC Group Plc holds more than 50% of the share capital of both DEF Ltd and GHY Ltd. Therefore, the three companies are connected with each other - ABC Group Plc controls both companies and DEF Ltd and GHY Ltd are controlled by the same person (ie ABC Group Plc).

GHY Ltd and MNO Ltd are connected as GHY Ltd, having 60% of the shares in MNO Ltd, controls MNO Ltd. MNO Ltd is also connected with ABC Group Plc and DEF Ltd by virtue of the 'further connections' rule.

This means that only one employment allowance is available to ABC Group Plc, DEF Ltd, GHY Ltd or MNO Ltd. The group will be able to choose which of the companies will make the claim.

The shareholdings in QRZ Ltd held by ABC Group Plc (25% held directly plus 3.3% held indirectly through subsidiaries (55% x 60% x 10%)) and by MNO Ltd directly (10%) mean that QRZ is not connected with either company, or any other company connected with ABC Group Plc or MNO Ltd (ie DEF Ltd and GHY Ltd).

QRZ Ltd does not need to share the Employment Allowance with these companies as it is not connected to the ABC Group Plc. However, it will need to check whether or not any other companies are connected with it and, if so, whether any of these has also made a claim.

Control can also be established through voting power, rights to income and rights to surplus assets on a winding up. This example assumes that these are held in direct correlation to the issued share capital for the sake of simplicity which may not always be the case.

Example 2: control

Mr Smith owns an electrical company, S Electrics Ltd. At the start of the tax year, S Electrics Ltd is able to acquire the majority (over 50%) of the voting rights in a supplier, L Lighting. S Electrics is connected with L Lighting as it has control of L Lighting. Only one of these companies would be entitled to the Employment Allowance.

Example 3: My group has created a new subsidiary company after the start of the tax year - will this company be entitled to the Employment Allowance?

TUV Ltd is the parent company of the TUV Group. It has 3 wholly owned subsidiary companies. At 6 April 2014, TUV Ltd will need to identify which one of the subsidiary companies (or the parent company) will claim the Employment Allowance. If the company chosen to claim the Employment Allowance runs several PAYE schemes, it will also need to decide on which scheme to operate the allowance.

If between 7 April 2014 and 5 April 2015, TUV Ltd acquires or creates a new subsidiary company, the new company will not be treated as having any connected companies for the remainder of the tax year and will be free to make a claim. At 6 April 2015, the new company will be caught by the connected persons rule so it will only be entitled to claim the allowance if no other companies in the TUV Ltd group do so.

Can I claim the balance of any Employment Allowance due from one PAYE scheme against a separate PAYE scheme that I am responsible for?

This is dependent on whether the separate businesses are set up as incorporated (limited companies) or as unincorporated (sole trader) businesses.

Example: Difference between unincorporated and incorporated businesses

Peter is a sole trader and is the owner and manager of a fish restaurant and also a florists shop. They are 2 separate unincorporated businesses, with separate PAYE schemes, separate premises and separate staff. The only connection between the 2 businesses is the owner, Peter. There will only be entitlement to one Employment Allowance for Peter in his capacity as the secondary contributor in respect of both businesses and Peter will have to decide from which PAYE scheme the Employment Allowance will be deducted. If, however, the total secondary Class 1 NICs on the nominated PAYE scheme are less than £2,000, Peter can request that the unused balance is set against the PAYE scheme for the other business after the end of the tax year.

Paula owns a toy shop and a turf accountants. Both are incorporated businesses (limited companies) with separate PAYE schemes, separate premises and separate staff. The only connection between the 2 companies is the owner, Paula. Each company is a secondary contributor but there will only be entitlement to one Employment Allowance as the companies are connected. Paula would have to decide which company claims the Employment Allowance. If the company that claims the Employment Allowance has employers Class 1 NICs of less than £2,000 in the tax year, Paula is not able to claim any outstanding balance on the other company's PAYE scheme as the companies are connected through Paula having control of both businesses which are limited companies,

The test of substantial commercial interdependence

This test determines whether 2 companies are connected with each other if the relationship between them is not one of 'substantial commercial interdependence'. The factors to be taken into account include whether the companies are financially interdependent, economically interdependent and organisationally interdependent.

This test is only relevant to companies that are only connected once rights in those companies are attributed between connected persons. For example, Janet and Peter are brother and sister. Janet owns J Ltd and Peter owns P Ltd. As Janet and Peter are siblings (associates), the rights they hold respectively in each company can be attributed to each other. So Janet is treated as controlling J Ltd and P Ltd, as is Peter. However, J Ltd and P Ltd are only treated as connected companies if there is substantial commercial interdependence between them. This is because, if the 2 businesses are completely unrelated (for example, Janet and Peter live hundreds of miles away from each other and have little contact), it would be unfair to deny the allowance to one of the companies.

When might a company be financially interdependent?

Two companies are financially interdependent if (in particular) either of the following apply:

- one gives financial support (directly or indirectly) to the other
- each has a financial interest in the affairs of the same business

Examples of tests of financial interdependence

Example 1: financial interdependence

On retiring, Mr Field sold his farming business to his sons, Gavin and Henry. The 2 sons raised the money to buy their father's farm through a joint loan from the bank secured against the assets of the business. On taking over the farm they split it into 2 companies, one of which was owned by Gavin and the other by Henry. Both companies undertake similar, albeit not identical activities, using substantially common facilities, staff and equipment. This situation remains in force at the start of the tax year. While the 2 companies are separately owned, the level of financial, economic and organisational interdependence between Gavin and Henry and their companies mean that their 2 companies are associated. Therefore, only one of the companies would be able to claim the employment allowance provided that there were no other connections.

Example 2: non financial interdependence

At the start of the tax year, Robert is the major shareholder and director of XYZ Computing Ltd which provides IT services. His son, Steve, is the major shareholder and director of S Management Ltd which provides business management services. Robert provided, as a family, rather than business matter, a personal guarantee in respect of a bank loan made to S Management Ltd when Steve set up the business. The companies are controlled by connected individuals but there is no financial (or other) link between the 2 companies because the guarantee has been given by Robert in a personal capacity and this financial support has no link to XYZ Computing Ltd - the companies are therefore not associated. Both XYZ Computing Ltd and S Management Ltd would be entitled to an employment allowance.

If, however, the loan to S Management Ltd was made direct from XYZ Computing Ltd or Robert had given additional security over the assets of XYZ Computing Ltd in support of his loan, there would be a financial link between the 2 businesses, either directly or indirectly, which could cause the companies to be 'associated'.

Example 3: non financial interdependence

At the start of the tax year, Lucy is the major shareholder and director of Lucy's Lorries, a large road haulage company. Her son Pat is the sole shareholder in Wood and Co, a furniture business, which Pat has built up from scratch and runs with his wife. The premises occupied by Wood and Co are owned by Lucy but Wood and Co pays a market rent for them. The 2 companies are controlled by associated individuals (mother and son) but there is no financial (or other) link between the companies. Lucy has never had any involvement with Wood and Co and Pat has never had any involvement in Lucy's Lorries. Since there are no financial links, beyond a simple rental of premises on market terms, the companies are not interdependent and therefore not 'associated companies'. Therefore, both Lucy's Lorries and Wood and Co. would be entitled to an employment allowance provided that there were no other connections.

Example 4: non financial interdependence

Some years ago Xavier Johnson started a taxi business 'Town Taxis' using money loaned to him by his wife Mrs Johnson. This was secured against the assets of her property rental business, 'Homes for You'. Town Taxis was successful and over time paid off the loan in full. At the start of the tax year, neither Mr Johnson nor Mrs Johnson has any involvement in the other's business and similarly, the 2 companies have no links to one another - the loan having been paid off several years ago. In the absence of any links between the 2 companies, whether financial, economic or organisational, Mrs Johnson and Homes for You's historic link with Town Taxis is not relevant and the 2 companies are not associated. Both Town Taxis and Homes for You, would be entitled to an employment allowance provided that there were no other connections.

Example 5: non financial interdependence

Mr Joy owned a newsagents 'Joy's News' and a joinery business 'Joy's Joiners'. On retirement Mr Joy's son bought all of the shares in Joy's News and Mr Joy's daughter bought all of the shares in Joy's Joiners. At the start of the tax year, neither Mr Joy's son or daughter has any involvement in the other's company and the companies themselves have no economic, financial or organisational links. Regardless of Mr Joy's previous ownership of both, Joy's News and Joy's Joiners are not associated. Both Joy's News and Joy's Joiners would be entitled to an employment allowance provided that there were no other connections.

When might a company be economically interdependent?

Two companies are economically interdependent if (in particular) one of the following applies:

- the companies seek to realise the same economic objective
- the activities of one benefit the other
- the companies have common customers

Examples of tests of economic interdependence

Example 1: Economic interdependence

At the start of the tax year, Christine Hall is the major shareholder in Yellow Drinks and a 49% shareholder in Careful Caterers Ltd. The 2 companies operate a large public house, which is popular for family dining as well as having a thriving wet trade. Yellow Drinks handles wet sales and Careful Caterers Ltd, which is run by the majority shareholder, Christine's husband, manages the catering operation. Mr Hall has financed the purchase of the assets of the catering business from a family legacy and a loan to Careful Caterers Ltd which he is guaranteeing personally. Both businesses are insured separately. Each business fully meets its own costs, and the catering business is charged a commercial rate for the use of the shared premises, employees and facilities. Although there is no cross subsidy, the 2 companies share a common economic goal with a common customer base and mutually beneficial activities. In addition, the 2 companies are organisationally interdependent, sharing premises and employees. The 2 companies are accordingly associated. Only one of the companies would be able to claim the employment allowance provided that there were no other connections.

Example 2: Economic interdependence

At the start of the tax year, Marjorie is the major shareholder in Washers Ltd, a dry cleaning business. Marjorie has also opened a second dry cleaning business in the same town. This is run by Spinners Ltd, of which Marjorie is the sole shareholder. Spinners Ltd offers specialist services in relation to wedding and evening dresses in addition to the normal range of dry cleaning facilities. Washers Ltd acts as agent for these specialist services which it does not have the ability to supply itself. Spinners Ltd and Washers Ltd share the same basic economic objective and their activities are of mutual benefit. The companies are therefore associated. Only one of the companies would be able to claim the employment allowance provided that there were no other connections.

Example 3: Non economic interdependence

Andrew and Benjamin are brothers who have built up successful internet businesses from modest beginnings when sharing a flat together as students. From the start, both were interested in the business possibilities of web site design. At the start of the tax year, Andrew is the major shareholder and director of Spiderweb Ltd which provides professional web design services, and Benjamin is the major director and shareholder of Grafix Ltd which provides graphic design services. Although their developing businesses benefited from the mutual exchange of ideas - especially in the early days - the brothers have had no other involvement in each other's

businesses, which operate entirely independently. The economic links between the 2 companies are too tenuous to associate them. Both Spiderweb Ltd and Grafix Ltd would be entitled to an employment allowance provided that there were no other connections.

Example 4: Non economic interdependence

At the start of the tax year, Mr Armstrong is the major shareholder in Armstrong's Diner which runs a large restaurant. It also operates a delicatessen backed by its reputation as a restaurant. Mrs Armstrong, who is a chef trained in France, is the sole shareholder in Deluxe Dining which runs a gastronomically starred restaurant she has built up from scratch. Armstrong's Diner also imports delicacies from all over the world for sale on the internet - again backed by its reputation as a restaurant. Although Mr and Mrs Armstrong are husband and wife and in the same trade, there is no link between their companies, which have been trading since well before they knew each other. They are not associated. Both Armstrong's Diner and Deluxe Dining would be entitled to an employment allowance provided that there were no other connections.

Example 5: Non economic interdependence

At the start of the tax year, Leo Fox is the director and sole shareholder of Fancy Feet which operates a chain of shoe shops. His wife also runs a shoe shop through Footwork, a company in which she is the majority shareholder. Although the 2 companies are in the same line of business, there are no links between them and they operate entirely independently. Mr and Mrs Fox started their individual businesses long before they met and they have kept the 2 enterprises entirely separate. The 2 companies are operated by associated individuals but there is no link between them - they are not associated. Both Fancy Feet and Footwork would be entitled to an employment allowance provided that there were no other connections.

When might a company be organisationally interdependent?

Two companies are organisationally interdependent if (in particular) the businesses of the companies have or use common:

- management
- employees
- premises
- equipment.

Examples of tests of organisational interdependence

Example 1: Organisational interdependence

At the start of the tax year, Mr Young is the director and sole shareholder of Young's Hairdressing Ltd and Mrs Young is the major shareholder in Young's Hair Products Ltd. The 2 companies operate a chain of hairdressing salons. Young's Hairdressing Ltd provides hairdressing services and Young's Hair Products Ltd provides hairdressing products. Young's Hairdressing Ltd rents the premises, employs the stylists and receptionists and pays all the bills. There is no cross charge for the use of facilities. Credit card payments are accepted by the salons, the electronic swipe machines being in the name of Young's Hair Products Ltd. There is a single bank account to which the swipe machines are attached. At the end of each day the bankings are split between the 2 companies and transferred to their main bank current accounts. The accounts of the 2 companies do not truly reflect the situation of the businesses but are just an artificial division. In reality the 2 companies are part of a single organisation - there is just the one business. Only one of the companies would be able to claim the employment allowance provided that there were no other connections.

Example 2: Organisational Interdependence

Even if substantial commercial interdependence is not present, 2 companies may still be associated. For example, at the start of the tax year a husband and wife separately own the shares in and run 2 completely different and separate companies but the husband has made a loan to his wife's company and as part of that loan is entitled to the company's assets if it is wound up. The 2 companies will be associated, not through the focus of the interdependence rules - attribution of associates' rights - but because the husband will control both companies through his shareholding and rights to assets on winding up. In these cases, only one of the companies would be able to claim the employment allowance provided that there were no other connections.

Example 3: non organisational interdependence

At the start of the tax year, Mr and Mrs Brownless each run their separate companies from their family home which is owned by Mrs Brownless. Mr Brownless' company could not afford to buy or rent other accommodation to trade from. Apart from sharing the family home and the family's domestic telephone line for occasional business calls and internet access there are no other financial, economic or organisational links between the 2 companies. Although Mr Brownless' company could not survive organisationally or financially without use of the family home, there is no direct or indirect financial support from either his wife or his wife's company to either him or his company, and no organisational links which amount to substantial interdependence. Both companies would be entitled to an employment allowance provided that there were no other connections.

Example 4: non organisational interdependence

At the start of the tax year, Zack is the director and sole shareholder of P Builders Merchants Ltd. He and his son are directors of Q Building Products Ltd, and own 50% of the shares each. P Builders Merchants Ltd and Q Building Products Ltd run a builders yard selling wholesale to the building trade and retail to the public from the same premises, which Zack owns. P Builders Merchants Ltd is the trade wholesaler and has a 'trade only' counter. Q Building Products Ltd sells retail at a counter with its own access and parking in the yard. P Builders Merchants Ltd buys stock for both the wholesale and retail side but the product ranges, stocking levels and prices are different. There are separate telephone lines for the wholesaler and retailer. Zack charges P Builders Merchants Ltd a commercial rent. At the end of each week P Builders Merchants Ltd invoices Q Building Products Ltd for goods supplied at cost plus a small mark up. There is a proportionate division of overhead costs and P Builders Merchants Ltd invoices Q Building Products Ltd an additional charge for other facilities. Wages for common employees are split in proportion between the 2 businesses. There are separate sale terms and tills for the businesses and they operate separate bank accounts and credit and credit card facilities. Each business has its own vehicles and the costs are kept strictly separate.

Where several business activities are operated from the same or adjoining premises, and the existence of one underpins the viability of the other, the companies will be interdependent. While the 2 companies may operate at arms length, there are significant organisational and economic links such that the retail business could not operate without the wholesale side. Accordingly, the companies will be associated. Only one of the companies would be able to claim the employment allowance provided that there were no other connections.

Connections through holding of fixed-rate preference shares

The holding of fixed rate preference shares by another company need to be considered if the company is a 'close company' (ie a company which is under the control of 5 or fewer participators or of its directors), takes no part in the management or control of the company which issued the

shares and subscribed for the shares in the ordinary course of a business, including the provision of finance (eg by a venture capital fund).

I hold fixed-rate preference shares in a company. Are my company and the company I hold the fixed rate preference shares in connected for the purposes of the Employment Allowance?

Certain financial institutions, notably the venture capital funds that seek to support smaller developing companies, may provide finance by taking up preference shares rather than by making loans. In some cases the degree of share ownership is sufficient to give the investor company control.

To determine whether the investor and target companies are associated, or companies under the common control of the investor company are associated with each other fixed rate preference shares are disregarded for the purpose of determining control if the company holding them meets all the following conditions. It:

- is not a close company
- takes no part in the management or conduct of the issuing company or in the management or conduct of its business
- subscribed for the shares in the ordinary course of a business which includes the provision of finance

For definitions of a close company, please see:

- <http://www.hmrc.gov.uk/manuals/ctmanual/ctm60060.htm> for a broad definition
- <http://www.hmrc.gov.uk/manuals/ctmanual/CTM60100.htm> for tests to determine whether a company is a close company

What type of fixed-rate preference shares count for this purpose?

Fixed-rate preference shares for this purpose are defined as shares which:

- were issued wholly for new consideration
- do not carry any right either to conversion into shares or securities of any other description or to the acquisition of any additional shares or securities
- do not carry any right to dividends other than dividends which:
 - are of a fixed amount or at a fixed rate per cent of the nominal value of the shares
 - together with any sum paid on redemption, represent no more than a reasonable commercial return on the consideration for which the shares were issued

Example

At the start of the tax year, Company X, an investment company, holds fixed-rate preference shares in company Y. Company X is controlled by 4 people; Betty, Sarah, Hussain and Giles. Company X is a close company, therefore, the fixed rate preference shares that company X holds in company Y cannot be ignored. These preference shares give company X the greater part of the issued share capital of company Y. Therefore company X controls company Y and only one of these companies would be entitled to the Employment Allowance.

What is the minimum controlling combination principle in determining control of a company?

A 'minimum controlling combination' means a group of persons which has control of the company but which would not have control of it if any one of the persons were excluded from the group.

More than one person or one group of persons may 'control' a company. For example, one person may have the greater part of the voting power, while 2 people hold the greater part of the issued share capital and a group of 3 people are entitled to the greater part of the assets in a winding up of the company. All 3 combinations of people can be said to have control of the company at the same time.

If 3 persons, A, B and C, each hold one third of the shares in a company, and they are not connected in any way which would allow the rights and powers of one to be attributed to another, then control is held by A and B, or B and C, or A and C but not A, B and C together.

This is because in determining whether companies are 'associated companies', only 'minimum' controlling combinations should be considered and combinations containing unnecessary members should be ignored.

For example, a company controlled by the unconnected persons D, E and F together, but not by any one or two of them alone should not be regarded as associated with any company controlled by one of them alone or by any two of them.

Two companies are only under the control of the same persons if:

- a group which controls one company is identical with a group which controls the other
- for each company, that group is a 'minimum controlling combination'

Example 1

In company AAA, at the start of the tax year, there are 150 ordinary shares in issue. Alan, Brenda and Caroline hold 50 shares each.

Alan and Brenda control company AAA, as do Alan and Caroline or Brenda and Caroline as, collectively, they hold the majority (two thirds) of the issued share capital of company AAA. Therefore any 2 of the shareholders together control company AAA. It is unnecessary to include the third shareholder in determining control of company AAA as control has already been established by combining the shareholdings of the 2 shareholders in accordance with the minimum controlling combination principle.

Where the minimum controlling combination principle applies to determine control of a company and, as a result of applying the principle companies are connected, then only one company would be entitled to the Employment Allowance.

Example 2

In company ZZZ, at the start of the tax year, there are 200 ordinary shares in issue. As well as holding shares in company AAA, Alan, Brenda and Caroline all hold 50 shares each in company ZZZ. The fourth shareholder in company ZZZ, also holding 50 shares, is Derek. Company ZZZ is controlled, using the minimum controlling combination principle by any of the 3 shareholders together.

As the minimum controlling combination for company AAA consists of 2 people and the minimum controlling combination for company ZZZ consists of 3 people there is no identical group of people controlling company AAA and company ZZZ and therefore the companies are not connected.

However if Alan and Brenda's shares together or Alan and Caroline's shares together or Brenda and Caroline's shares together entitled them to the greater part of the voting power in company ZZZ, then there would be an identical group controlling both companies, and so the 2 companies AAA and ZZZ would be associated.

The minimum controlling combination also applies where it entitles those with control to the greatest share of the company income upon distribution of company income and/or where those with control are entitled to the greatest part of the company assets upon a winding up.

What is a loan creditor?

A loan creditor is a creditor in respect of any redeemable loan capital issued by the company or any debt relating to money borrowed or capital assets acquired by the company, any right to receive income created in favour of the company, or debt for which the value of the consideration to the company at the time the debt was incurred was substantially less than the amount of debt.

A loan creditor is also a person who is not the creditor in respect of any debt or loan capital but has a beneficial interest in the debt or loan capital.

A person who carries on a banking business is not classified as a loan creditor for money lent in the ordinary course of business.

How does the connection through a loan creditor work?

When determining whether one company controls another, a loan creditor is disregarded if there is no other connection between it and the company to which the loan was made **and** either the loan creditor is not a close company or the loan was made in the ordinary course of a business carried on by the creditor.

Examples

Company A is not under the control of company B if, at the start of the tax year, company B is a loan creditor of company A which arose in the ordinary course of business, there is no other connection between companies A and B and company B is not a close company of company A.

Similarly, if at the start of the tax year, companies A and B share a loan creditor companies A and B will not be connected provided that the loan creditor is not a close company of companies A or B and that the position as a loan creditor arose in the ordinary course of business.

Note that a connection between companies A and B means any past or present connection or dealings between them.

How can my company be connected with another company through using the same trustee?

Where 2 companies are under the control of the same person by virtue of rights or powers held in trust by that person, and there is no other connection between the 2 companies, those rights and powers held in trust are ignored when determining whether the 2 companies are connected (the trustee may, for example, be a solicitor or the trustee company of a bank).