

CORPORATION TAX ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Part 10: Close companies

Overview

1316. This Part rewrites sections 414 to 417 and 419 to 422 of ICTA and Schedule 12 to FA 1989, which are concerned with close companies.
1317. A company controlled by a small group of persons may arrange its affairs to enable those persons to avoid income tax. The close company provisions in Part 11 of ICTA counter this.
1318. The close company legislation, as such, has two main effects. First, section 418 of ICTA extends the meaning of “distribution” to encompass certain benefits which may be disguised distributions of profit to the shareholders or their families. Section 418 is rewritten in this Act as part of the legislation on distributions. See section 1064. Second, section 419 of ICTA imposes tax in respect of certain loans made to shareholders or their families which could in practice represent the extraction of profits without the payment of tax by those persons. Section 419 is rewritten in Chapter 3 of this Part.
1319. Other legislation imposes further restrictions on close companies. For example, close companies which are “close investment-holding companies” (as defined in section 13A of ICTA) are not entitled to claim to pay the rate of corporation tax for companies with small profits. Section 13A is rewritten in this Act as part of the legislation on relief for companies with small profits. See section 34.
1320. The term “control” is defined for close company purposes in section 416 of ICTA. This definition is also widely used in other contexts. Section 416 is rewritten in Chapter 2 of this Part.

Chapter 1: Overview of Part

Section 438: Overview of Part

1321. This section introduces the Part. It is new.
1322. In its present form, the close company legislation in Part 11 of ICTA largely dates back to 1965. The opportunity has been taken to disentangle its structure.
1323. The definitions of the key technical terms are located near the beginning of the Part, in Chapter 2.
1324. [Chapter 3](#) imposes the charge to tax in connection with loans or advances by close companies to participators.
1325. [Chapter 4](#) contains a power to obtain information in connection with close companies.

1326. “Participant” is used for the first time in this Part in *subsection (2)*. Its definition is signposted in *subsection (4)*.

Chapter 2: Basic definitions

Overview

1327. This Chapter defines which companies are and are not to be close companies. It has the following structure.

- Sections 439 to 441 define “close company”.
- Sections 442 to 447 make exceptions to the rules in sections 439 to 441.
- Sections 448 to 454 define some expressions used in this Part and, in particular, in defining “close company”. These definitions are arranged in alphabetical order.

Section 439: “Close company”

1328. This section is the first of a group of three sections defining “close company”. It is based on section 414(1), (2) and (2D) of ICTA.

1329. *Subsection (1)* provides that there are two alternative tests to determine whether a company is a close company.

1330. The first test, condition A in *subsection (2)*, focuses on control over the company.

1331. The second test, condition B in *subsection (3)*, focuses on rights to assets in the event that the company is wound up.

1332. *Subsection (4)* gives a signpost to the exceptions to this section in sections 442 to 447.

1333. *Subsections (5) and (6)* relate to condition B in *subsection (3)*. *Subsection (5)* provides for *subsection (3)* to be supplemented by section 451. *Subsection (6)* gives a signpost to section 441, which supplements *subsection (3)*.

1334. “Control” and “director” are used for the first time in this Part in *subsection (2)*, and “loan creditor” is used for the first time in *subsection (3)*. Signposts to their definitions are given in *subsection (7)*.

Section 440: Basis of winding up under section 439(3)

1335. This section quantifies the part of the assets available for distribution among the participants which a person is entitled to receive in the notional winding up under section 439(3). It is based on section 414(2A) and (2B) of ICTA.

Section 441: Treatment of some persons as participators or directors for the purposes of section 439(3)

1336. This section supplements section 439(3). It is based on section 414(2C) of ICTA.

Section 442: Particular types of company

1337. This section is the first of a series of sections stipulating that certain companies are not to be treated as close companies. It is based on section 414(1) and (2) of ICTA.

Section 443: Companies controlled by or on behalf of Crown

1338. This section provides that certain companies controlled by or on behalf of the Crown are not to be treated as close companies. It is based on section 414(1) and (4) of ICTA.

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1339. *Subsection (1)* provides that “a company is not to be treated as a close company *as a result of section 439(2)* if it is controlled by or on behalf of the Crown.” The italicised words are based on “and not otherwise a close company” in section 414(1)(c) of ICTA.
1340. The italicised words leave it open for a company controlled by or on behalf of the Crown to be a close company if condition B in section 439(3) is met. Section 439(3) is based on section 414(2) of ICTA.
1341. The italicised words also leave it open for a company controlled by or on behalf of the Crown to be a close company if condition A in section 439(2) is satisfied by reference to persons acting independently of the Crown. See *subsection (3)*.
1342. In short, section 414(1)(c) of ICTA is a qualified exception to section 414(1) of that Act but not an exception to section 414(2) of that Act.

Section 444: Companies involved with non-close companies

1343. This section provides that certain companies involved with non-close companies are not to be treated as close companies. It is based on section 414(5) and (6) of ICTA.
1344. *Subsections (2) and (3)* rewrite section 414(5)(a) and (b) of ICTA respectively.

Section 445: Section 444: registered pension schemes

1345. This section supplements section 444; it is concerned with shares held on trust for registered pension schemes. It is based on section 414(7) of ICTA.
1346. *Subsection (1)* is based on the full-out words at the beginning and end of section 414(7) of ICTA. In summary, a registered pension scheme within subsection (1) is treated as a non-close company.
1347. *Subsection (2)* is based on the “unless”-clause in the full-out words at the beginning of section 414(7) of ICTA. It is the first part of an exception to subsection (1). It focuses on the individuals for whose benefit the scheme is established.
1348. *Subsection (3)* is based on section 414(7)(a) to (c) of ICTA. It is the second part of the exception to subsection (1). It focuses on the companies of which the individuals in subsection (2)(a) are or were directors or employees.
1349. “Associate” and “associated company” appear for the first time in subsection (3). Their definitions are signposted in *subsection (4)*.

Section 446: Particular types of quoted company

1350. This section provides that certain quoted companies are not to be treated as close companies. It is based on section 415(1), (2) and (6) to (8) of ICTA.
1351. *Subsection (1)* lays down the general rule.
1352. *Subsection (2)* makes an exception to the general rule in subsection (1).
1353. Subsection (2) uses the concept of a “principal member” of a company. This term is defined in *subsection (3)*.
1354. *Subsection (4)* qualifies subsection (3).
1355. Subsections (1) to (4) focus on voting power. *Subsection (5)* supplements the references to voting power in those provisions.

Section 447: Section 446: meaning of “shares beneficially held by the public” etc

1356. This interpretative section is based on section 415(3) to (8) of ICTA.
1357. *Subsection (1)* lays down the general rule.

1358. *Subsection (2)* makes an exception to that rule.
1359. *Subsection (3)* specifies the individuals in subsection (2)(e).
1360. *Subsection (4)* rewrites the tail words of section 415(3) of ICTA. It supplements the references to unconditional allotment and unconditional acquisition in section 446(1).
1361. *Subsections (5) to (8)* supplement this section or provisions of this section.

Sections 448 and 449: “Associate”; “associated company”

1362. These interpretative sections are based on sections 416(1) and 417(3) and (4) of ICTA.

Section 450: “Control”

1363. This interpretative section is based on section 416(2) and (3) of ICTA.
1364. *Subsection (1)* specifies that this definition of “control” applies for the purposes of this Part. The definition of “control” in section 840 of ICTA is rewritten in section 1124.
1365. *Subsection (2)* rewrites the general proposition in the opening words of section 416(2) of ICTA.
1366. *Subsection (3)* rewrites the specific propositions in section 416(2)(a) to (c) of ICTA.
1367. *Subsection (4)* rewrites as a separate stipulation the words in brackets in section 416(2) (b) of ICTA.
1368. *Subsection (5)* rewrites section 416(3) of ICTA.

Section 451: Section 450: rights to be attributed etc

1369. This section supplements section 450. It is based on section 416(4) to (6) of ICTA.
1370. *Subsections (2) and (3)* rewrite, respectively, section 416(4) and (5) of ICTA.
1371. *Subsections (4) to (6)* rewrite section 416(6) of ICTA, paragraphing it and breaking it up into sense-units.
1372. Sections 439(5), 446(5) and 447(6) provide for the application of provisions of this section.

Section 452: “Director”

1373. This interpretative section is based on section 417(5) and (6) of ICTA.
1374. Section 417(5) of ICTA refers to “the company’s trade or business”. Section 6(4) (b) of ICTA provides that, in Part 11 of that Act, “trade” includes “vocation” and also includes an office or employment. A company cannot carry on an employment. In relation to a company, “business” is apt to include an office. *Subsection (2)* therefore does not provide that “trade” includes an office or employment. In addition, *subsection (2)* includes a minor change in the law, in that it does not provide that “trade” includes “vocation”. See *Change 4* in Annex 1.
1375. Section 417(5)(b) of ICTA has the phrase “directly or through the medium of other companies or by any other indirect means”. It follows from the meaning of “other” that “through the medium of other companies or by any other indirect means” can be compressed to “by any indirect means”. Compare Viscount Radcliffe’s remarks on “interest, annuities, or other annual payments” in *CIR v Frere* (1964) 42 TC 125 HL on page 152. And, as a matter of normal English usage, “by any indirect means” is synonymous with “indirectly”. *Subsection (2)(b)(ii)* therefore compresses the phrase under review to “directly or indirectly”.

1376. In section 417(6) of ICTA, if a person (P) is deemed to own whatever P's associates own or control, then "either on his own or with one or more associates" is otiose. *Subsection (3)* therefore omits it. And subsection (3) goes on to omit as otiose "even if he does not own or control share capital on his own".

Sections 453 and 454 "Loan creditor"; "participator"

1377. These interpretative sections are based on section 417(1), (2) and (7) to (9) of ICTA.

Chapter 3: Charge to tax in case of loan to participator

Section 455: Charge to tax in case of loan to participator

1378. This section imposes a charge to tax if a close company makes a loan, or advances money, to a participator or an associate of a participator. It is based on section 419(1) to (3), (6) and (7) of ICTA.
1379. *Subsection (1)* states when this section applies. It uses the expression "relevant person", which is defined in *subsection (6)*.
1380. *Subsection (2)* imposes the charge.
1381. *Subsection (3)* states when the tax is due and payable.
1382. *Subsection (4)* extends the scope of the charge. It is based on section 419(2) of ICTA, which is expressed to apply for the purposes of that section. *Subsection (4)* is expressed to apply for the purposes of, among other things, section 456 – that is, including the provisions of that section which are based on section 420 of ICTA. Since section 420 of ICTA makes exceptions to section 419 of that Act, defining the scope of *subsection (4)* in this way does not change the law.
1383. *Subsection (5)* extends the circumstances in which a person is treated as being a participator in a company.

Section 456: Exceptions to the charge under section 455

1384. This section makes certain exceptions to the charge under section 455. It is based on sections 419(1) and 420 of ICTA.
1385. *Subsection (1)* is an exception for money-lending companies.
1386. *Subsection (2)* is an exception for ordinary supplies of goods and services.
1387. *Subsection (2)* refers to a company's "trade or business". It does not refer to a company's "vocation". This is a minor change in the law. See the commentary on section 452 and *Change 4* in Annex 1.
1388. *Subsections (3) to (8)* are an exception for small amounts.
1389. *Subsections (3), (4) and (7)* apply not only to loans but also to advances. This is a minor change in the law to bring it into line with practice. See *Change 30* in Annex 1.

Section 457: Section 456: meaning of "material interest in a company"

1390. This interpretative section is based on section 420(2) of ICTA.
1391. The closing sentence of section 420(2) of ICTA attracts, with modifications, section 168(11) of ICTA. Section 168(11) of ICTA has been rewritten in section 68 of ITEPA and repealed. This section largely replicates section 68 of ITEPA.
1392. Section 168(11) of ICTA is reproduced below for the reader's convenience, as it stood before ITEPA and as modified by section 420(2) of ICTA.

“A person shall be treated as having a material interest in a company if he, either on his own or with one or more associates, or if any associate of his with or without such other associates –

- (a) is the beneficial owner of, or able, directly or through the medium of other companies, or by any other indirect means, to control more than 5 per cent of the ordinary share capital of the company, or
- (b) in the case of a close company, possesses, or is entitled to acquire, such rights as would in the event of the winding up of the company or in any other circumstances, give an entitlement to receive more than 5 per cent of the assets which would then be available for distribution among the participators.

In this subsection “associate” has the same meaning as in section 417(3), except that for this purpose “relative” in that subsection has the meaning given by section 160(6), and “participator” has the meaning given by section 417(1).

1393. The closing sentence of section 420(2) of ICTA provides for the words following “417(3)” to be omitted, and the words in strikethrough reflect this. But this omission merely disapplies the definition of “relative” in section 160(6) of ICTA. It does not extend to the underlined words, because omitting the underlined words would leave “participator” undefined. FA 1989 inserted the underlined words into section 168(11) of ICTA by way of consequential amendment, and it appears that the need to make a further consequential amendment to section 420(2) of that Act was overlooked.
1394. *Subsection (2)(b)* has been compressed for the sake of brevity and consistency with section 452(2)(b)(ii). See the commentary on that provision.

Section 458: Relief in case of repayment or release of loan

1395. This section gives relief from tax in cases in which:
- a loan or advance from a close company has given rise to a charge under section 455, and
 - the loan or advance is repaid or the debt in respect of it is released or written off.
1396. It is based on section 419(4) to (4B) of ICTA.
1397. *Subsection (1)* states when the section applies.
1398. *Subsection (2)* specifies the relief and the circumstances in which it is given.
1399. *Subsection (3)* is about claiming the relief. It reflects paragraph 21 of Schedule 39 to FA 2008, which substitutes “4 years” for “six years” in section 419(4) of ICTA with effect from 1 April 2010.
1400. If the company becomes eligible for relief after the tax due under section 455 becomes due and payable, *subsections (4)* and *(5)* defer the relief.
1401. *Subsection (6)* sets the link with TMA.

Section 459: Loan treated as made to participator

1402. This section blocks arrangements to circumvent the charge under section 455. It treats certain loans or advances, which would otherwise be outside the scope of that section, as having been made to a relevant person. It is based on section 419(5) and (7) of ICTA.
1403. *Subsection (1)* states when the section applies.
1404. *Subsection (2)* is the main operative provision.
1405. Section 419(5) of ICTA provides for that section to apply as if the loan or advance had been made to the individual in question. *Subsection (2)*, which is based on

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section 419(5), provides for sections 455 to 458 to apply. These sections include provisions which are based on section 420 of ICTA. Since section 420 of ICTA makes exceptions to section 419 of that Act, defining the scope of subsection (2) in this way does not change the law.

1406. *Subsection (3)* makes two exceptions to this section.
1407. *Subsection (4)* extends the circumstances in which a person is treated as a participator in a company.

Section 460: Loan treated as made by close company

1408. This section extends the scope of sections 455 to 459 to catch loans or advances made by certain companies which are controlled by other companies. It is based on section 422(1) to (3) and (6) of ICTA.
1409. *Subsection (1)* states when the section applies.
1410. *Subsection (2)* prescribes the consequences if the company (C) making the loan or advance is controlled by a close company.
1411. *Subsection (3)* prescribes the consequences if C is not controlled by a close company but a close company subsequently acquires control of it.
1412. Subsections (2) and (3) operate in relation to section 459, because the references in section 422(1) and (2) of ICTA to section 419 of that Act pick up section 419(5) of that Act.
1413. *Subsection (4)* deals with the case in which two or more close companies control C.
1414. *Subsections (5)* and *(6)* are signposts.
1415. *Subsection (7)* extends the circumstances in which a company is deemed to make a loan.

Section 461: Exception to section 460

1416. This section makes an exception to section 460. It is based on section 422(4) and (6) of ICTA.

Section 462: Determination of particular questions as a result of section 460

1417. This section supplements sections 455 to 459. It is based on section 422(5) and (6) of ICTA.
1418. *Subsection (1)* states when the section applies. It operates in relation to section 459 for the reason given in the commentary on section 460(2) and (3).
1419. *Subsection (2)* lists the questions which come within this section, and requires them to be determined by reference to the company labelled C in section 460(1).

Section 463: Taxation of debtor on release of loan to trustees of settlement which has ended

1420. This section deems income to arise to a company for corporation tax purposes in certain circumstances when a loan or advance from a close company is released or written off. It is based on section 421 of ICTA.
1421. This section deals with the following case, as specified in *subsections (2) to (5)*.
- A close company (X) makes a loan or advance to the trustees of a settlement.
 - Another company (Y) becomes the debtor in respect of this loan or advance.

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- After the settlement has ended, X releases or writes off the whole or part of the loan or advance.

1422. *Subsection (6)* is the main operative provision.

1423. *Subsection (7)* quantifies the income. Section 421(1)(a) of ICTA uses the word “gross” in a manner analogous to “grossing up” as defined in section 1128(3) of this Act. *Subsection (7)* therefore uses a formula to rewrite section 421(1)(a) and (b) of ICTA on the lines of the formula in section 1128(3).

Section 464: Section 463: other person treated as releasing or writing off debt

1424. This section supplements section 463. It is based on section 422(5) of ICTA.

1425. *Subsection (1)* states when the section applies. It operates in relation to section 459 for the reason given in the commentary on section 460(2) and (3).

1426. *Subsection (2)* is the operative provision.

Chapter 4: Power to obtain information

Section 465: Power to obtain information

1427. This section gives HMRC power to obtain information about close companies. It is based on Schedule 12 to FA 1989.