

A little Tax Planning goes a long way

Question:

Myself and my brother equally own two companies which have profits in excess of £300,000. I have been advised that we can reduce our annual corporation tax bill by £22,500 every year by making a small 1% adjustment to our shareholdings. How can we take advantage of this tax savings?

Answer:

The rate of corporation tax which is levied on companies varies depending on the size of taxable profits generated in the company. Companies pay a lower level of corporation tax of only 20% if their profits are less than £300,000. Profits exceeding this level are taxed at 27.5%. To prevent companies deliberately fragmenting their businesses into many companies to utilise the 20% tax band several times HMRC divide the £300,000 threshold across the number of associated companies which exist. A company is treated as being associated with another company if one of the two has control of the other or if both are under the control of the same person or persons. To have control of a company an individual is generally required to own at least 51% of the company's shares. As you own 50% of each company you do not control either company on your own. Control is exercised by you and your brother 'together', as it is your combined shareholding which satisfies the equity control test. The legislation which defines associated companies and control is quite complex. In determining if an individual has control of a company the rights and shareholdings of their relatives and business partners are also deemed to belong to the individual. So for example, if you owned 45% of a company and your wife owned 10%, the tax legislation would view your shareholding as being 55% and hence you would be treated for tax purposes as a controlling shareholder. There is, however, a special concession which allows the relaxation of this rule in certain circumstances. If it is possible to prove that there is no commercial dependence between the companies under review, only the shares of minor children and spouses are taken into consideration when determining if you control each company. It is the relaxation of this rule which facilitates tax planning to be carried out. Currently, your two companies are "associated" as both companies are under common control, which means they are controlled by you and your brother together. As a result, the first £150,000 profits you generate in each company is taxed at 20% with the balance being taxed at 27.5%. If the combined profits of both companies is £600,000 this is an annual tax bill of £142,500.

If you were willing to make a small adjustment to your shareholding in each company by just 1%, the tax savings each year would be significant. You might consider increasing your shareholding to 51% in company A and reducing your shareholding in Company B to 49%, with the balance of equity in each company owned by your brother. This adjustment allows you to control company A on your own as you would own more than 50% of the company and your brother would control company B on his own. As a result, company A and B would no longer be treated as associated companies for the purposes of determining the rate of tax which applies to their profits. Therefore the first £300,000 of profits in each company would be taxed at 20%, resulting in a reduction in corporation tax of £22,500 each year. This tax planning opportunity is only applicable if the companies under review are not deemed to be commercially dependant on one another and it is therefore necessary to consider all the links between the companies and their businesses to ensure this special tax planning concession applies.

Specific tax advice should be sought before implementing tax planning strategies or making adjustments to equity holdings.

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