

# RELATED COMPANIES SIMPLIFICATION REVIEW: UPDATE- DECEMBER 2007

As part of the Government's commitment to tax simplification, this year's Pre-Budget report launched three simplification reviews. One of these is looking at how to simplify the corporation tax rules for related companies. Following feedback from business about what work to prioritise, this paper details those areas where there is scope for future simplification work.

Business strongly identifies the associated company rules for the small companies corporation tax rate and the group aspects of corporation tax on chargeable gains as priorities for simplification. In these areas, HM Treasury and HM Revenue & Customs will work with business to identify both short- and longer-term improvements.

Over a longer timeframe, the Review team will also examine the scope for improvements to the CTSA filing and payment arrangements for groups and the burden of transfer pricing rules.

Business is now invited to express an interest in those elements of this work in which they wish to be involved in the future and should contact the Review team ([relatedcompanies.simplification@hm-treasury.gov.uk](mailto:relatedcompanies.simplification@hm-treasury.gov.uk)) to express their interest in some or all of the workstreams identified in this paper.

**1.1** As part of his 2007 Pre-Budget Report announcement on tax simplification, the Chancellor announced a review aimed at simplifying the rules for the taxation of related companies. Following feedback from business about what work to prioritise, this paper identifies the priority areas for future simplification work.

**1.2** Over 143 replies were received to the online survey and to the related companies simplification inbox. The responses came from a range of interested parties, including professional advisers and representative groups.

**1.3** This paper sets out the criteria used to determine priorities and the work that will be taken forward in the short-term, with a view to identifying potential improvements that might be announced at Budget 2008 or consulted upon further during 2008. Business is invited to express interest in engaging in any of these workstreams.

## BUSINESS VIEWS ON THE 2007 PRE-BUDGET REPORT PROPOSALS

**1.4** Four areas of the corporation tax rules for related companies were identified by Government as possible priorities for simplification. For each area the paper outlines what was announced at the 2007 Pre-Budget Report, analyses the business response, and explains how this work will be progressed in consultation with business

**1.5** The criteria used to decide priorities include: the level of external support for prioritising the work and the extent to which external and internal views coincide on likely simplifications.

## THE GROUP ASPECTS OF CORPORATION TAX ON CHARGEABLE GAINS

**1.6** In an increasingly knowledge-based global economy, the UK's future economic success depends crucially on the ability to generate innovative ideas and to translate new knowledge into high-value products and services.

**Pre-Budget Report proposals** **1.7** The regime for the taxation of corporate gains has a number of longstanding provisions aimed at ensuring tax is only levied on gains realised when an asset is disposed of outside a group. The Pre-Budget Report proposed that there may be scope for simplifying some of these rules as well as aligning the tax outcome more closely to the economic effect for the group.

**1.8** HM Treasury and HMRC specifically sought views on:

- What should comprise a group for the purposes of corporation tax on chargeable gains.
- The treatment of assets transferred between group companies.
- The offsetting of gains and losses within a group.
- The treatment of companies on joining and leaving a group.
- Whether the taxation of the chargeable gains of a group of companies is fair and accords as far as possible with economic outcome

**Business response** **1.9** Around 30 per cent of all respondents identified the group aspects of chargeable gains as relevant to their/clients'/members' business activities. Among those who expressed a view, there was broad agreement (almost 90 per cent) that there was scope to simplify this part of the corporation tax system; and around 60 per cent felt that the group aspects of chargeable gains should be prioritised as part of the review.

**1.10** The main areas mentioned by a number of individual responses as priorities for simplification were:

- The offsetting of gains and losses within a group
- The treatment of companies without share capital in a group, particularly in relation to the substantial shareholdings exemption
- The potential for alignment of the definitions of a group of companies across the taxes acts.
- Degrouping charges

**1.11** In particular, a number of respondents suggested that a system of transferable capital losses within groups could replace the current arrangements whereby actual or notional transfers of assets are used to match gains and losses of different companies.

**1.12** Another of the tax simplification reviews announced in the Pre-Budget Report concerned anti-avoidance rules. Some suggestions made for reform of anti-avoidance rules overlap with areas covered by the corporate gains element of the related companies review. The main areas of common concern mentioned were the variety of

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group definitions in the tax code and value shifting rules, which can particularly impact on transactions by groups of companies.

**Next steps 1.13** There is a clear mandate to prioritise this work, although business views on possible improvements go a little wider than the work identified at the Pre-Budget Report, pointing towards the need for a more substantive reform of the regime, rather than piecemeal simplifications. The Government will take this work forward through a series of stakeholder meetings beginning with a planning meeting towards the end of January to agree on a timetable for this work in the short- and longer-term.

### **THE IMPACT OF ASSOCIATED COMPANY RULES ON SMALL COMPANIES' RATE**

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**Pre-Budget Report proposals 1.14** The associated company rules have existed for many years and, by and large, still perform the function for which they were adopted: a deterrent against income fragmentation for the purpose of the small companies rate. However when associated company rules were introduced, partnerships were limited in size and the administrative burden of establishing the number of associated companies controlled by business partners was not great. Limits on the size of partnerships have now been lifted and partnerships can be very much larger than was previously the case. Business has made representations that this increase in partnership size can in some cases cause problems in establishing the number of associated companies. The Pre-Budget Report proposed that there may be scope for simplification of the associated company rules as they apply to the small companies rate.

**Business response 1.15** Around 40 per cent of all respondents identified the impact of associated company rules on the small companies rate as relevant to their/clients'/members' business activities. Among those who expressed a view, there was clear agreement (over 90 per cent) that there was scope to simplify this part of the corporation tax system; and again over 90 per cent felt that this should be prioritised as part of the review.

**1.16** Business identified particular issues in the following areas:

- Identifying the number of associated companies, not just in relation to the eligibility for small companies rate.
- The application of Extra-Statutory Concession C9; a number of requests to legislate this concession were received.
- Instances where the rules apply to treat companies as associated even when there was no intent to fragment the business

**Next steps 1.17** There is an obvious mandate to prioritise this work but business views on possible improvements go rather wider than the work identified at the Pre-Budget Report, pointing towards the need for a more wide ranging review of the associated company rules. Nonetheless, the limited area identified by the Pre-Budget Report may be appropriate for reforms in the 2008 Budget. Government will take this work forward through a series of stakeholder meetings beginning with a planning meeting towards the end of January to agree on a timetable for this work in the short- and longer-term.

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## CTSA FILING AND PAYMENT ARRANGEMENTS FOR GROUPS

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**Pre-Budget Report proposals** **1.18** Arrangements already exist in certain, currently limited, circumstances for payments and tax information to be provided to HMRC on a group basis, for example group Quarterly Instalment Payments and claims to group relief. The Pre-Budget Report proposed that there may be scope to review the efficacy of these existing arrangements with business and identify the potential for improving and extending such arrangements to reduce administrative costs for business.

**Business response** **1.19** Just 16 per cent of all respondents identified the CTSA filing and payment arrangements for groups as relevant to their/clients'/members' business activities. Among those who expressed a view, whilst there was general agreement (over 78 per cent) that there was scope to simplify this part of the corporation tax system, less than half (44 per cent) felt that this should be prioritised as part of the review.

**Next steps** **1.20** There is no clear mandate to prioritise this work, but sufficient interest to justify keeping this as a potential candidate for further work to a longer time scale.

## BURDEN OF TRANSFER PRICING RULES

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**Pre-Budget Report proposals** **1.21** HMRC recognises that business wants greater certainty and speedier resolution of transfer enquiries leading to reduced compliance costs. This is being addressed through the Review of Links with Large Business, and HMRC is introducing a new approach to transfer pricing enquiries. The Pre-Budget Report proposed that the simplification review might build on this dialogue to discuss whether the burdens caused by transfer pricing in cross-border or domestic situations can be further reduced


**Business response** **1.22** Just 18 per cent of all respondents identified the burdens of transfer pricing rules as relevant to their/clients'/members' business activities. Among those who expressed a view, 62 per cent felt that this should be prioritised as part of the review.

**Next steps** **1.23** There is no clear mandate to prioritise this area, but sufficient interest to suggest that we continue to look to make progress including how we can build on the implementation of the 'Review of Links with Large Business' in this area. The Government will continue discussions at a more informal level with those who expressed an interest to see whether there is more that can be done within the context of transfer pricing.

## CONCLUSIONS

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**1.24** The first stage of the related companies' simplification review has identified the priority areas for improvement in both the short- and longer-term. Business representatives will be invited to participate in this work. Other recipients who wish to be involved in this work should contact the Review Team



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(relatedcompanies.simplification@hm-treasury.gov.uk) to express their interest in some or all of the workstreams identified in this paper.