

Loans and associated companies (Lecture B1404 – 13.41 minutes)

Associated companies became relevant (again) from 1 April 2023 in determining (inter-alia) the profit limits for:

1. Determining the rate of corporation to apply from 1 April 2023; and
2. Whether the company needs to pay its corporation tax by instalments (or accelerated instalments) for accounting periods beginning on or after 1 April 2023.

Previously, we have focused on how shareholdings and voting control impact on determining if two or more companies are associated, but loans to companies, or between two companies can create associated companies as well.

Companies are associated if at any time in the past 12 months, one company controls the other or both are under the control of the same person.

Control

P controls C if P exercises, is able to exercise, or is entitled to acquire direct or indirect control over C's affairs.

P is treated as controlling C if possesses or is entitled to acquire:

1. The greater part of the share capital or issued share capital of C;
2. The greater part of the voting power in C;
3. So much of the issued share capital of C as would, on the assumption that the whole of the income of C were distributed among the participators, entitle P to receive the greater part of the amount so distributed; or
4. **Such rights as would entitle P, in the event of the winding up of C or in any other circumstances, to receive the greater part of the assets of C which would then be available for distribution among the participators.**

Participators (s454 CTA 2010)

1. A shareholder or holder of rights to acquire share capital or voting rights;
2. **A loan creditor of the company** – defined in s453 CTA 2010 and includes a debt for capital assets acquired as well as a regular loan;
3. A person entitled to (or entitled to acquire a right to) receive or participate in distributions of the company or any amounts payable (in cash or in kind) to loan creditors by way of premium on redemption;
4. A person entitled to secure that income or assets (now or in future) of the company will be applied directly or indirectly for the person's benefit.

Loan creditors – exception (s181 CTA 2010)

A Ltd is not under the control of B Ltd for these purposes if:

1. B is a loan creditor of A (i.e., B lends to A);
2. There is no other connection between them; and
3. Either
 - a. the lender is not a close company, or
 - b. If it is, the loan arose in the ordinary course of business carried on by the lender.

Example 1

A Ltd is a family-owned company and is not a member of a group.

B Ltd, a trading company owned by a friend of the family, lends £400,000 to A Ltd, with a floating charge against the company's assets.

A Ltd's assets during the year ended 31 December 2023 ranged from £750,000 to £1,000,000.

There were other unsecured creditors, apart from B Ltd of approximately £50,000 throughout the year.

Are A Ltd and B Ltd associated companies?

Analysis

A and B will be associated if, at any point in the year ended 31 December 2023, B Ltd is entitled to more than half of the assets available to participators (i.e., the loan creditors and shareholders).

The minimum amount available to participators (lenders and shareholders) was (£750,000 - £50,000) £700,000 – because the trade creditors would be entitled to payment before the shareholders.

B Ltd would be entitled to £400,000 in a winding-up in priority to unsecured creditors because of its floating charge, i.e., more than 50% of the assets available.

A Ltd and B Ltd are associated.

If B Ltd was either not a close company, or it was a money-lending company, the companies would not be associated.

Interestingly, the law makes no mention of accruing liquidators' costs, but these would have priority over floating charge holders. It would make sense to deduct estimated liquidators' costs to arrive at assets available to lenders and shareholders, but it is unclear if the law requires this.

Example 2

A Ltd is a family-owned company and is not a member of a group.

B Ltd, a trading company owned by a friend of the family, lends £450,000 to A Ltd on an unsecured basis.

A Ltd's assets during the year ended 31 December 2023 ranged from £1,000,000 to £1,500,000.

There were other unsecured trade creditors of approximately £50,000 throughout the year and secured third-party bank loans of £230,000.

Are A Ltd and B Ltd associated companies?

Analysis

The bank cannot be associated with A Ltd, but it is a participator.

The minimum assets available for distribution amongst the participators (lenders and shareholders) is £950,000 (£1,000,000 - £50,000).

The bank would receive £230,000, leaving £720,000 to pay B Ltd and the shareholders if the company is wound up.

B Ltd is entitled to £450,000, i.e., less than 50% of the assets available to participators (i.e., the bank, B Ltd and the shareholders).

A Ltd and B Ltd are not associated.

Other points

The examples focus on one company lending to another company. Two companies will be associated if there is common control.

For example, if an individual was a majority shareholder in company A, and lent money to company B with an entitlement to more than half the assets in a winding up, A and B would be associated companies.

In practice, would we know the assets available to participators at all times in the previous 12 months....? So how can we carry out the test in practice, according to the letter of the law ('at any time...')?

The same sort of analysis as in the above examples would be needed for someone who is a shareholder and has also lent the company money.

If they do not control the company through their shareholding, do they control it from an entitlement to more than half of the assets available to participators in a winding up – i.e., the amount they would receive from being both a loan creditor and a shareholder?

Contributed by Malcolm Greenbaum