EXPLANATORY MEMORANDUM TO

THE CORPORATION TAX ACT 2010 (FACTORS DETERMINING SUBSTANTIAL COMMERCIAL INTERDEPENDENCE) ORDER 2011

2011 No. 1784

1. This explanatory memorandum has been prepared by HM Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 The Order sets out the factors to be taken into account when determining, for the purposes of section 27 (attribution to persons of rights and powers of their associates) of the Corporation Tax Act 2010, whether a relationship between two companies amounts to "substantial commercial interdependence".

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 The Order is made in exercise of the powers conferred by section 27(3) of the Corporation Tax Act 2010 and section 55(5) of the Finance Act 2011.

4. Legislative Context

4.1 Section 27 of the Corporation Tax Act 2010 sets out the circumstances in which rights and powers held by their associates can be attributed to a person, for the purpose of establishing whether companies are under common control.

4.2 Section 27 previously operated automatically, leading to companies being associated by mere accident of circumstance. The changes to this section in the Finance Act 2011 ensures that companies are associated only where substantial commercial interdependence exists between them.

4.3 New section 27(3) allows HM Treasury, by order, to prescribe factors that are to be taken into account in determining whether a relationship between two companies amounts to "substantial commercial interdependence". This Order sets out the factors to be applied to make this determination.

4.4 The Order has retrospective effect; it applies to accounting periods ending on or after 1 April 2011. This is permitted by section 55(5) of the Finance Act 2011.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 Section 55 of the Finance Act 2011 substitutes a new section 27 of the Corporation Tax Act 2010. The provision previously automatically attributed, between connected persons, rights held in the companies, leading to companies being associated by mere accident of circumstance.

7.2 Where companies are determined to be associated, this may lower the profit threshold at which they fall within the main rate of corporation tax.

7.3 The change to section 27 ensures that companies are no longer held to be associated by mere accident of circumstance, but rather only where the level of commercial interdependence between companies makes it appropriate to do so, e.g. when it is "substantial".

7.4 The effect of this change is very largely relieving.

7.5 The Order exercises powers, conferred by section 27(3) of the Corporation Tax Act 2010, to set out the factors to be taken into account when determining whether a relationship between two companies amounts to "substantial commercial interdependence".

- ***Consolidation***

7.6 Not applicable.

8. Consultation outcome

8.1 A consultation document entitled *Simplification review: the associated company rules as they apply to the small companies' rate of corporation tax* was published on 28 October 2009 – 17 responses were received.

8.2 March 2010 Budget announced the introduction of reforms of the rules to take effect from 1 April 2011. The June 2010 Budget confirmed that the reforms would go ahead as previously announced.

8.3 In July 2010 the summary of responses to the consultation was published along with draft legislation and guidance. All documents are available on the HM Treasury website.

9. Guidance

9.1 Guidance on the amended legislation can be found in the Corporation Tax manual on the HMRC website.

10. Impact

10.1 Tax Information and Impact Note covering this instrument was published, on 9th December 2010, alongside draft legislation and is available on the HMRC website at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 No separate approach is required to minimise the impact of the requirements on small firms employing up to 20 people.

12. Monitoring & review

12.1 HMRC will monitor the impact of the order through information collected from tax returns and receipts.

13. Contact

Simon Moulden at HMRC (tel: 020 7147 2629 or email: simon.moulden@hmrc.gsi.gov.uk) can answer any queries regarding the Order.