HMRC - INTM248500 - Alphabetic Index Of Terms Defined In Part 9A: Interests In Companies

Where an apportionment falls to be made under step 3 of TIOPA10/S371BC(1), the CFC’s chargeable profits and creditable tax are apportioned among the persons who had an interest in the CFC at any time during the accounting period in question. TIOPA10/S371VH specifies the circumstances in which a person has such an interest.

In many cases the only interest needing to be considered will be shareholdings. However there are other ways in which a person may effectively control or derive benefit from a company: for example, through special rights in a winding up or through the ability to secure that income or assets are applied on their direction. The definition of persons with an interest in a CFC has therefore been drawn widely.

TIOPA10/S371VH(2) provides the basic rules for identifying persons who have an “interest” in a company. It outlines four circumstances in which a person has an “interest” in a company:

any person who has, or is entitled to acquire, share capital or voting rights in the company;

any person who has, or is entitled to acquire, a right to receive or participate in distributions of the company (as defined by CTA10/S1000(web));

any person who is entitled to direct how income or assets of the company are to be applied, to have such income or assets applied on their behalf, or otherwise to secure that such income or assets are applied directly or indirectly for their benefit. References to a person being entitled to do anything in this circumstance covers cases in which it is reasonable to suppose that a person is presently able or will at a future date become able to do the thing, even if the person has no present or future entitlement to do the thing; and

any other person who can control the company, either alone or with other persons.

Subsection (3) of TIOPA10/S371VH expands a “person’s entitlement to do anything” in all four circumstances to cover cases in which a person is presently entitled to do anything at a future date or will at a future date become entitled to do it. It does not extend to situations where, in an entirely arm’s length transaction, one party temporarily has future rights over the other’s property; for instance, in the period between exchange of contracts and completion of a sale of land.

Subsection (6) of TIOPA10/S371VH applies if a person’s entitlement or ability to do anything under (c) above is contingent on a default of any person, including the CFC in question. For the purposes of (c) above, such a person will not be treated as having an interest in the CFC unless that default has occurred. If a borrower is in breach of, say, a provision in a loan agreement but this failure is not pursued by the bank, and no powers are assumed by the bank under subsection (2)(c), a default will not be taken to have occurred under subsection (6).

For example, a person will have an interest in a CFC if, by means of a contractual right or some other arrangement, he can:

require a shareholder to transfer shares to him, or

secure the issue to him of unissued share capital of the CFC, or

secure that if a distribution is made by the CFC, he has a share in the distribution or premium.

A person will not have an interest in a CFC solely by virtue of rights over the income or assets of the company which are exercisable on the default of any person. Thus the contingent rights of banks, trade creditors, etc. to acquire some or all of the company’s assets in the event of a default would not amount to an interest in the company in advance of the default.

Rights as a loan creditor

Rights that a person has as a loan creditor are generally excluded from being interests in a company. The meaning of loan creditor for these purposes is that given in CTA10/S453 (web), except that the exclusion in subsection (4) of CTA10/S453 for loans made in the ordinary course of a banking business is set aside.

Any rights arising from a loan relationship with an embedded derivative need to be considered separately. An embedded derivative takes the meaning given to it at CTA09/S415(1)(b)(web), which applies where a company treats the rights and liabilities under a loan relationship to which it is party as divided between;

rights and liabilities under a loan relationship, and

rights and liabilities under a derivative financial instrument or equity instrument.

In these circumstances the rights arising on the derivative financial instrument or equity instrument will amount to an interest in a company where the loan creditor separately accounts for the derivative as described above and in accordance with generally accepted accounting practice (i.e. UK generally accepted accounting practice (GAAP) or international accounting standards).

Where accounts for a loan creditor are not prepared in accordance with GAAP or international accounting standards, it is assumed that accounts have been prepared in accordance with international accounting standards in applying the CTA09/S415(1)(b) definition.

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Indirect interests

A person may hold an indirect interest in a CFC. Subsections (11) to (13) of TIOPA10/S371VH cover circumstances where a person (or two or more persons together) have an interest in a company and that company has an interest in a second company. Each of those persons has an interest in the second company equivalent to a proportion of the first company’s interest, determined by reference to the extent of that person’s interest in the first company.

For example, where person A has a 50 percent interest in company 1 which has an 80 percent interest in company 2, these provisions treat person A as having an interest equal to 50 per cent of company 2’s interest. Hence A has a 40 percent interest in company 2. The interaction of subsections (11) and (12) mean that an indirect interest that a person holds in company 1 can be traced through a chain of intermediate companies between company 1 and company 2.

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Joint interests held other than in fiduciary or representative capacity

Where two or more persons jointly have an interest in a company other than in a fiduciary or representative capacity, they are treated as having the interest in equal shares.