



# Finance Act 1965

## 1965 CHAPTER 25

### PART IV

#### TAXATION OF COMPANIES AND OF COMPANY DISTRIBUTIONS.

##### *Close companies.*

#### **74 Restriction for close companies on deduction for directors' remuneration.**

- (1) In computing for corporation tax the profits of a close company for any accounting period, the deduction that may be made for the remuneration of directors other than whole-time service directors shall not, subject to subsection (2) below, exceed, fifteen per cent. of the company's profits, computed before making any deduction for that remuneration or for investment allowances, and with the addition of franked investment income from companies not within its group (if it has one):

Provided that for any accounting period for which the company so elects this subsection shall apply with the substitution for the reference to fifteen per cent. of the company's profits for that period of a reference to fifteen per cent. of the profits of a period of the same length, computed as aforesaid but according to the average of the three years preceding the accounting period, or of such part (not being less than twelve months) of those three years as falls after the company commenced to carry on business or became resident in the United Kingdom, so, however, that in arriving at the average for a period beginning before the year 1966-67 there shall be brought into the computation profits arising from the company's trade or business which are chargeable to profits tax, computed as for that tax, together with any such franked investment income (within the meaning of that tax) as would not, if received in like circumstances after the year 1965-66, be treated as coming from within the company's group.

For this purpose distributions received by the company from another are to be treated as coming from within the company's group if but only if dividends so received are group income or would be group income if the companies so elected, and, where the proviso to this subsection has effect, the amount of the profits of the three years there mentioned or the relevant part of those three years shall, if the case requires, be arrived

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at by division and apportionment or aggregation of profits or losses for periods of account wholly or partly comprised therein.

- (2) Subsection (1) above shall not reduce the deduction for any accounting period below £4,000 nor, if there are for more than half the accounting period at least two directors to whom subsection (3) below applies, below the aggregate remuneration, within the limits permitted by subsection (3), of those directors.
- (3) This subsection applies to directors who are required to devote substantially the whole of their time to the service of the company in a managerial or technical capacity but are not whole-time service directors, and the limits on the deduction permitted by reference to their remuneration are as follows:—
  - (a) an overall limit of £13,000, reduced to £10,000 if for half or more of the accounting period there are less than four such directors, and to £7,000 if for half or more of it there are less than three; and
  - (b) a limit of £4,000 on the remuneration of the highest paid such director and £3,000 on that of any other, except that if the remuneration of the highest paid such director is less than £4,000, an amount equal to the difference may be made up on the remuneration of the others.

" The highest paid such director ", if no one such director is the highest paid, means one such director having remuneration as high as that of any of the others.

- (4) In relation to an accounting period of less than twelve months each of the sums of money numerically specified in subsections (2) and (3) shall be proportionately reduced.
- (5) Where a company is a close company for part only of an accounting period and the deduction which would otherwise be allowable for that period for directors' remuneration is decreased under this section, the decrease shall be such part of that which would be made apart from this subsection as is proportionate to that part of the period.
- (6) This section shall apply in relation to a company having more than one source of income so as to restrict the aggregate deductions to be made in any manner for the remuneration of directors, including deductions giving rise to or augmenting a loss.

## **75 Assessment of close companies to income tax in respect of certain loans.**

- (1) Where after the end of the year 1965-66 a close company, otherwise than in the ordinary course of a business carried on by it which includes the lending of money, makes any loan or advances any money to an individual who is a participator in the company or an associate of a participator, there shall be assessed on and recoverable from the company, as if it were an amount of income tax chargeable on the company, an amount equal to income tax on the grossed up equivalent of the loan or advance.
- (2) Where, after a company has paid the amount assessed on it under subsection (1) above in respect of any loan or advance, the loan or advance or any part of it is repaid to the company, the amount paid by the company or a proportionate part of it shall be repaid.
- (3) Where a company is assessed or liable to be assessed under this section in respect of a loan or advance, and releases or writes off the whole or part of the debt in respect of it, the person to whom it was made shall be treated for purposes of surtax as having then received an amount of income equal to the grossed up equivalent of the amount so released or written off:

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Provided that if the loan or advance was made to a person who has since died, or to trustees of a trust which has come to an end, this subsection instead of applying to the person to whom it was made shall apply to the person from whom the debt is due at the time of the release or writing off (and if it is due from him as personal representative within the meaning of Part XIX of the Income Tax Act 1952, the amount treated as received by him shall accordingly be, as regards surtax, included for purposes of the said Part XIX in the aggregate income of the estate).

- (4) For purposes of this section the grossed up equivalent of an amount is such sum as after deduction of income tax at the standard rate is equal to that amount, and shall be computed by reference to the standard rate for the year of assessment in which the loan or advance is made or, as the case may be, the debt is wholly or partly released or written off.
- (5) Subsection (3) of this section shall not have effect in relation to a loan or advance made to a person if any sum falls in respect of the loan or advance to be included in his income by virtue of section 408 of the Income Tax 1952, except in so far as the amount released or written off exceeds the sums previously falling to be so included (without the addition for income tax provided for by section 408(4)); and where any amount is included in a person's income by virtue of subsection (3) above in respect of any loan or advance, there shall be a corresponding reduction in the amount (if any) afterwards falling to be so included in respect of it by virtue of the said section 408.
- (6) Where under arrangements made by any person otherwise than in the ordinary course of a business carried on by him—
- (a) a close company makes a loan or advance to a person who is not a participator in the company or an associate of a participator; and
  - (b) some person other than the close company makes a payment or transfers property to, or releases or satisfies (in whole or in part) a liability of, an individual who is a participator in the company or an associate of a participator;
- then, unless in respect of the matter referred to at (b) above there falls to be included in the total income for purposes of surtax of the participator or associate an amount not less than the grossed up equivalent of the loan or advance, this section shall apply as if the loan or advance had been made to him.
- (7) In subsections (1) and (6)(b) above the references to an individual shall apply also to a company receiving the loan or advance in a fiduciary or representative capacity and to a company not resident in the United Kingdom.

## **76 Assessment of close companies on consideration for certain restrictive covenants etc.**

- (1) Where, in respect of any payment made or consideration given by a company after the year 1965-66, any sum falls by virtue of section 242 of the Income Tax Act 1952 (charge of surtax on consideration for certain restrictive covenants etc.) to be included in an individual's total income for purposes of surtax, and at the time when the payment is made or the consideration is given the company is a close company and the individual is a participator in the company or an associate of a participator, there shall be assessed on and recoverable from the company, as if it were an amount of income tax chargeable on the company, an amount equal to income tax on the sum falling to be included in the individual's income as aforesaid, at the standard rate for the year of assessment in which the payment is made or consideration is given.

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- (2) Where subsection (1) above would apply to any payment or consideration if the condition that the company is a close company and the individual a participator in it or an associate of a participator were satisfied at the time when the payment is made or the consideration is given, the subsection shall apply if either—
- (a) at that time the individual holds or is about to hold an office or employment with the company and the condition is satisfied within two years afterwards ;
  - or
  - (b) at that time the individual holds or has held an office or employment with the company and the condition has been satisfied within two years previously.

**77 Shortfall in distributions of close company (income tax at standard rate).**

- (1) If in any accounting period of a close company there is a shortfall in the company's distributions, there shall be assessed on and recoverable from the company, as if it were an amount of income tax chargeable on the company, an amount equal to the income tax for which the company would be liable to account under section 47(3) of this Act on a distribution equal in amount (before deduction of income tax) to the shortfall and made twelve months after the end of the accounting period (income tax having been deducted).
- (2) For the purposes of this section the shortfall in a company's distributions for any accounting period is, save as otherwise provided by this section, the amount (if any) by which the distributions for the period fall short of the required standard; and the required standard is the distributable income for the period, less so much of that income (not exceeding, in the case of a company which is neither a trading company nor a member of a trading group, the amount of the estate or trading income) as the company shows could not be distributed without prejudice to the requirements of the company's business :

Provided that the required standard shall in no case exceed the company's distributable investment income for the period plus sixty per cent. of the estate or trading income of the period, and for the purpose of this proviso in its application to a trading company not having any associated company the estate or trading income for the period, if it is less than £9,000, shall be treated as reduced by one-fifth of the amount required to make it up to £9,000 or, if it is less than £1,500, shall be disregarded.

- (3) In arriving at the required standard for any accounting period—
- (a) regard shall be had not only to the current requirements of the company's business but also to such other requirements as may be necessary or advisable for the maintenance and development of that business, but for this purpose sections 246(2) and (3) and 258(1) and (4) of the Income Tax Act 1952, except section 246(2) proviso, shall apply as they applied for the corresponding purpose of section 245 ;
  - (b) the amount of the estate or trading income shall be taken at the amount included in respect of it in the distributable income;
  - (c) for an accounting period of less than twelve months the sums of £9,000 and £1,500 specified in the proviso to subsection (2) above shall be proportionately reduced ;
  - (d) if the company is a trading company and for part of the period has, and for part of the period has not, got an associated company, the required standard shall be arrived at by aggregating the amounts for those parts separately computed as if they were distinct accounting periods.

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- (4) Where a company is subject to any restriction imposed by law as regards the making of distributions, any shortfall in its distributions for an accounting period shall be disregarded to the extent to which the company could not make distributions up to the required standard without contravening that restriction.
- (5) Where a company is in respect of any year of assessment assessed under this section in respect of a shortfall in distributions, and there is in that year a surplus of franked investment income (including any amount carried forward from an earlier year), the company may claim that the shortfall shall be set off as far as may be against that surplus, and each of them shall then (as regards the company) be treated as reduced by the amount of the set-off.

Effect shall be given to a claim under this subsection in priority to any claim for the same year under section 62 of this Act, but the set-off shall be made as far as may be against any part of the surplus which has been carried forward from an earlier year of assessment.

- (6) Where a company is assessed under this section in respect of a shortfall in distributions for any accounting period, then (so long as the company remains a close company) it may for any later accounting period for which there is no such shortfall claim that the shortfall of the earlier period, or so much of it as has not been dealt with under this subsection, shall, in determining the income tax payable by the company in respect of distributions for the later period or, as the case may be, in arriving at any surplus of franked investment income, be deducted rateably from the distributions made by the company for the later period :

Provided that no deduction shall be made under this subsection from the distributions for any accounting period so as to reduce those distributions below the required standard or below the amount of the directors' remuneration included in the distributions in computing them for purposes of this section.

## **78 Apportionment for surtax of close company's income.**

- (1) Subject to the provisions of this section, the income of a close company for any accounting period may for purposes of surtax be apportioned by the Board among the participators, and any amount apportioned to a close company (whether originally or by one or more sub-apportionments under this provision) may be further apportioned among the participators in that company; and on any such apportionment section 249 of the Income Tax Act 1952, as adapted by this section, shall apply as it applied on an apportionment of a company's income under Chapter III of Part IX of that Act.
- (2) For purposes of an apportionment under this section, there shall be added to the amount of income to be apportioned any amounts which were deducted in respect of annual payments in arriving at the company's distributable income for the accounting period and which in the case of an individual would not have been deductible or would have been treated as his income in computing his total income for surtax.
- (3) Except in the case of a trading company, there may be apportioned under this section, if the Board see reason for it, the whole of a company's income for an accounting period up to the amount of the required standard (notwithstanding that there has been no shortfall in distributions for that period), together with any addition to be made under subsection (2) above but with such reduction, if any, as may be just in respect of distributions made for the period to persons other than participators and associates of participators (or amounts treated as such for purposes of section 77 above) :

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Provided that for this purpose the required standard shall be treated as reduced by so much of any shortfall in the distributions for the period as would under section 77(4) above be disregarded in an assessment made in respect of that shortfall.

- (4) Subject to subsections (2) and (3) above, an apportionment shall not be made under this section of a company's income for an accounting period unless an assessment is made on the company under section 77 of this Act in respect of a shortfall in its distributions for that period, and the amount apportioned shall be the amount of that assessment.
- (5) Any apportionment made under this section, including any sub-apportionment of an amount directly or indirectly apportioned to a company, shall be made according to the respective interests in the company in question of the participators, except that—
  - (a) in the case of any company, the provisos to section 258(3) of the Income Tax Act 1952 and section 259(1) of that Act (which enable regard to be had to beneficial interests in loans, or to the interests which would arise in a winding up) shall apply as they applied in the case of an investment company to apportionments under Chapter III of Part IX of that Act (a reference to a participator being substituted for any reference to a member or to a loan creditor); and
  - (b) if the company is not a trading company, section 260 of that Act (which gave further powers to have regard to underlying interests) except subsection (5) shall also apply in like manner.
- (6) Where an apportionment is made by virtue of subsection (3) above, an individual shall not be charged to surtax on an amount treated in consequence of the apportionment or any sub-apportionment as being his income except in so far as it exceeds the amount which, apart from the apportionment, falls in respect of distributions made by the company in the accounting period to be included in the statement of total income to be made by him for purposes of surtax ; and no individual shall be charged to surtax by virtue of any apportionment under this section unless the sum or (where there is a sub-apportionment) aggregate sum on which he is so chargeable amounts either to £100 or more or to five per cent. or more of the amount apportioned.
- (7) Subject to subsection (6) above, on an apportionment under this section, section 249 of the Income Tax Act 1952 shall apply subject to the following modifications:—
  - (a) for any reference to a member there shall be substituted a reference to a participator;
  - (b) subsection (2)(c) shall not apply, and any amount treated under the section as a person's income for purposes of surtax shall be deemed for those purposes to have been received by him at the end of the accounting period to which the apportionment relates; and
  - (c) there shall not be deducted from the amount apportioned to any person (whether on the original apportionment or any sub-apportionment) any amount in fact distributed to him; and
  - (d) so much of section 249(5) as provides for undistributed income not to rank for surtax when subsequently distributed shall not apply unless on the occasion of its distribution the distributions for the accounting period exceed the required standard, and shall then apply only to the same fraction of any amount to which an individual is entitled as that excess is of the whole distributions for the period.

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**79 Supplementary provisions about close companies.**

The provisions of Schedule 18 to this Act shall have effect for the interpretation and operation of the foregoing sections of this Act relating to close companies, for their modification in certain cases and for other purposes there dealt with; and those sections shall have effect subject to and in accordance with the provisions of that Schedule.