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SCHEDULES.

SCHEDULE 18

Section 79.

SUPPLEMENTARY PROVISIONS ABOUT CLOSE COMPANIES.

PART I

INTERPRETATION GENERALLY.

"Close company" and "associated company".

- 1 (1) For purposes of Part IV a "close company" is one which is under the control of five or fewer participators or of participators who are directors, except that the expression does not apply—
- (a) to a company not resident in the United Kingdom; or
 - (b) to a registered industrial and provident society within the meaning of section 442 of the Income Tax Act 1952, or to a building society within the meaning of section 445 of that Act or any other company to which section 445 applies; or
 - (c) to a company controlled by or on behalf of the Crown, and not otherwise a close company; or
 - (d) to a company falling within sub-paragraph (4) below.
- (2) Subject to sub-paragraph (4) below, a company resident in the United Kingdom (but not falling within sub-paragraph (1)(b) above) is also a close company if, on the assumption that it is so or on the assumption that it and any other such company or companies are so, more than half of any amount falling under Part IV of this Act to be apportioned for purposes of surtax in the case of the company could be apportioned among five or fewer participators or among participators who are directors.
- (3) A company is not to be treated as being at any time a close company if shares in the company carrying not less than thirty-five per cent. of the voting power in the company (and not being shares entitled to a fixed rate of dividend, whether with or without a further right to participate in profits) have been allotted unconditionally to, or acquired unconditionally by, and are at that time beneficially held by, the public, and any such shares have within the preceding twelve months been the subject of dealings on a recognised stock exchange, and the shares have within those twelve months been quoted in the official list of a recognised stock exchange; but for this purpose shares shall not be deemed to be allotted to, or acquired or held by, the public if they are allotted to, or acquired or held by—
- (a) any director or associate of a director of the company; or
 - (b) any company which is under the control of any such director or associate or of two or more persons each of whom is such a director or associate; or
 - (c) any associated company of the company.

In this sub-paragraph "share" includes "stock".

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- (4) A company is not to be treated as a close company in any case where—
- (a) by reason of beneficial ownership of shares in the company the control of it is in the hands of a company which is not a close company or of two or more companies none of which is a close company; and
 - (b) it could only be treated as a close company as being under the control of five or fewer participators, and it cannot be so treated except by taking as one of the participators a company which is not a close company;

but so that references in this sub-paragraph to a close company shall be construed as applying to any company which, if resident in the United Kingdom, would be a close company.

- (5) For the purposes of this paragraph a company is to be treated as controlled by or on behalf of the Crown if, but only if, it is under the control of the Crown or of persons acting on behalf of the Crown, independently of any other person ; and where a company is so controlled, it shall not be treated as being otherwise a close company, unless it can be treated as a close company as being under the control of persons acting independently of the Crown.

- 2 For purposes of the provisions of this Act relating to close companies, a company is to be treated as another's " associated company " at a given time if at that time, or at any time within one year previously, one of the two has control of the other or both are under the control of the same person or persons.

" Control ".

- 3 (1) For purposes of this Schedule a person shall be taken to have control of a company—
- (a) if he exercises, or is able to exercise, or is entitled to acquire, control, whether direct or indirect, over the company's affairs, and in particular, but without prejudice to the generality of the preceding words, if he possesses or is entitled to acquire, the greater part of the share capital or voting power in the company; or
 - (b) if he possesses or is entitled to acquire, either—
 - (i) the greater part of the issued share capital of the company ; or
 - (ii) such part of that capital as would, if the whole of the income of the company were in fact distributed to the members, entitle him to receive the greater part of the amount so distributed ; or
 - (iii) such redeemable share capital as would entitle him to receive on its redemption the greater part of the assets which, in the event of a winding up, would be available for distribution among members ; or
 - (c) if in the event of a winding up he would be entitled to the greater part of the assets available for distribution among members.

Where two or more persons together satisfy any of the conditions in paragraphs (a) to (c) above, they shall be taken to have control of the company.

- (2) In sub-paragraph (1) above " member " includes any person having a share or interest in the capital or income of the company, and for purposes of that sub-paragraph a person shall be treated as entitled to acquire anything which he is entitled to acquire at a future date or will at a future date be entitled to acquire ; but for the purposes of sub-paragraph (1)(b)(iii) and (c) any such loan creditor as is mentioned in paragraph 4(1)(b) below may be treated as a member (and the references to share capital as including loan capital).

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- (3) For purposes of sub-paragraph (1) above there shall be attributed to any person any rights or powers of a nominee for him, that is to say, any rights or powers which another person possesses on his behalf or may be required to exercise on his direction or behalf.
- (4) For purposes of sub-paragraph (1) above there may also be attributed to any person all the rights and powers of any company of which he has, or he and associates of his have, control or any two or more such companies, or of any associate of his or of any two or more associates of his, including those attributed to a company or associate under sub-paragraph (3) above but not those attributed to an associate under this sub-paragraph ; and such attributions shall be made under this sub-paragraph as will result in the company being treated as under the control of five or fewer participators, if it can be so treated.

" Participator " and " associate ".

- 4 (1) For purposes of Part IV a " participator " is, in relation to any company, a person having a share or interest in the capital or income of the company and, without prejudice to the generality of the preceding words, includes—
- (a) any person who possesses or is entitled to acquire share capital or voting rights in the company;
 - (b) any person who is a loan creditor of the company otherwise than in respect of any loan capital or debt issued or incurred by the company for money lent by him to the company in the ordinary course of a business of banking carried on by him;
 - (c) any person who possesses or is entitled to acquire a right to receive or participate in distributions of the company (as defined in Part I of Schedule 11 to this Act) or any amounts payable by the company (in cash or in kind) to loan creditors by way of premium on redemption ;
 - (d) any person who is entitled to secure that income or assets (whether present or future) of the company will be applied directly or indirectly for his benefit.
- (2) In sub-paragraph (1) above references to being entitled to do anything apply where a person is presently entitled to do it at a future date or will at a future date be entitled to do it; and " loan creditor" means a creditor in respect of any redeemable loan capital issued by the company or in respect of any debt incurred by the company, being a debt—
- (a) for money borrowed or capital assets acquired by the company; or
 - (b) for any right to receive income created in favour of the company; or
 - (c) for consideration the value of which to the company was (at the time when the debt was incurred) substantially less than the amount of the debt (including any premium thereon).
- 5 For purposes of the provisions of this Act relating to close companies, including this Schedule, " associate " means, in relation to a participator.—
- (a) a person in any of the following relationships to the participator, that is to say, husband or wife, parent or remoter forebear, child or remoter issue, brother or sister, and partner;
 - (b) the trustee or trustees of any settlement in relation to which the participator is, or any such relative of his (living or dead) as is mentioned in sub-paragraph (a) above is or was, a settlor (" settlement " and " settlor " here

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having the same meaning as in Chapter III of Part XVIII of the Income Tax Act 1952, and "relative" including a husband or wife);

- (c) where the participator is interested in any shares or obligations of the company which are subject to any trust or are part of the estate of a deceased person, any other person interested therein;

and has a corresponding meaning in relation to a person other than a participator.

"Director" and "whole-time service director".

- 6 (1) For purposes of the provisions of this Act relating to close companies, including this Schedule, "director" and "whole-time service director" have the meanings assigned to them by this paragraph.

- (2) "Director" includes any person occupying the position of director by whatever name called, any person in accordance with whose directions or instructions the directors are accustomed to act and any person who—

(a) is a manager of the company or otherwise concerned in the management of the company's trade or business; and

(b) is remunerated out of the funds of that trade or business; and

(c) is, either on his own or with one or more associates, the beneficial owner of, or able, directly or through the medium of other companies or by any other indirect means, to control twenty per cent. or over of the ordinary share capital of the company ("ordinary share capital" here meaning all the issued share capital, by whatever name called, other than capital the holders whereof have a right to a dividend at a fixed rate or a rate fluctuating in accordance with the standard rate of income tax, but have no other right to share in the profits of the company).

- (3) "Whole-time service director" means a director who is required to devote substantially the whole of his time to the service of the company in a managerial or technical capacity, and is not, either on his own or with one or more associates, the beneficial owner of, or able, directly or through the medium of other companies or by any other indirect means, to control, more than five per cent. of the ordinary share capital of the company ("ordinary share capital" here having the same meaning as in sub-paragraph (2)(c) above):

Provided that a person is not to be treated as a whole-time service director if, on an amount equal to the whole distributable income of the company (computed without regard to the restriction on deductions for directors' remuneration) falling under Part IV of this Act to be apportioned for purposes of surtax, more than five per cent. of that amount could be apportioned to him together with his associates (if any).

PART II

PROVISIONS SPECIALLY RELATED TO SHORTFALLS IN OR APPORTIONMENT OF DISTRIBUTIONS.

Descriptions of profits or income.

- 7 (1) The "distributable profits" of a company for an accounting period shall be the amount on which corporation tax falls finally to be borne, less the amount of that tax, but with additions equal to—

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- (a) any deduction made by virtue of section 87 of this Act by way of allowance in respect of any source of income; and
 - (b) any franked investment income, less the amount of any relief given against it for management expenses or charges on income ;
 - (c) any group income.
- (2) The " distributable income " of a company for an accounting period shall be the amount of the distributable profits exclusive of the part attributable to chargeable gains, which shall be taken to be the amount of the chargeable gains on which corporation tax is finally borne less the amount of that tax.
- (3) The " distributable investment income " of a company for an accounting period shall be the amount of the distributable income exclusive of the part attributable to estate or trading income and less whichever is the smaller of—
- (a) ten per cent. of the estate or trading income ; and
 - (b) £200 or, if the accounting period is of less than twelve months, a proportionately reduced amount.
- (4) The " estate or trading income " of a company means the income of the following descriptions:—
- (a) income which is not investment income for purposes of paragraph 8(1) below ; and
 - (b) income which is chargeable to tax under Schedule B or which is chargeable to tax under Schedule D and, not being yearly or other interest, arises from the ownership or occupation of land (including any interest in or right over land) or from the letting furnished of any building or part of a building.
- (5) The amount for part of an accounting period of any description of income referred to in this paragraph shall be a proportionate part of the amount for the whole period, and, in determining the amount for any period of any description of income, any deduction from the company's profits for charges on income, expenses of management or other amount deductible from profits of more than one description shall be treated as made from such profits, and in such proportions from those profits, as is appropriate.

" Trading company " and " trading group " .

- 8 (1) For purposes of the provisions of this Act relating to close companies, including this Schedule, a " trading company " is any company which exists wholly or mainly for the purpose of carrying on a trade and any other company whose income does not consist mainly of investment income, that is to say, income which, if the company were an individual, would not be earned income; but for this purpose any amount which is apportioned to a company under this Act, and any such amount as, in relation to a company to which section 245 of the Income Tax Act 1952 applied, is directed by any enactment to be treated as investment income, shall be deemed to be income of the company and to be investment income.
- (2) For the said purposes a company is to be treated as a " member of a trading group " if, but only if—
- (a) it exists wholly or mainly for the purpose of co-ordinating the administration of a group of two or more companies each of which is under its control and exists wholly or mainly for the purpose of carrying on a trade ; or
 - (b) it is under the control of another company resident in the United Kingdom and not itself under the control of a third company, and it exists wholly or

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mainly for the purpose of a trade or trades carried on by that other company or by a group which, consisting of that other company and a company or companies also under its control and resident in the United Kingdom, exists wholly or mainly for the purpose of carrying on the said trade or trades:

Provided that a company shall not be treated as a member of a trading group by reason of any company having the control of another, if that control is exercised through a company which is not resident in the United Kingdom or through a company whose control depends on a holding a profit on the sale of which would be treated as a trading receipt of the company.

Amounts to be taken into account as distributions for accounting periods.

- 9 (1) For the purpose of the provisions of this Act relating to shortfalls in the distributions of a close company the distributions for an accounting period shall be taken, subject to sub-paragraph (2) below, to consist of—
- (a) any dividends which are paid for the period and paid during or within twelve months after the period; and
 - (b) any amount by which the directors' remuneration paid for the period exceeds the deduction allowed for it in computing the income of the period ; and
 - (c) all distributions made in the period except dividends which in relation to any previous period would fall under paragraph (a) above.
- (2) Where a period of account is not an accounting period, dividends which, if it were an accounting period, would be treated under sub-paragraph (1)(a) above as distributions for that accounting period shall be apportioned to any accounting period or part of an accounting period falling within the period of account in proportion to the distributable income of each such period or part.

Procedure.

- 10 The following provisions of the Income Tax Act 1952 (which relate to appeals and to powers to obtain information) that is to say, section 248(2) and (3), section 250(3), (4) and (5) and section 264, shall apply in relation to section 78 of this Act with the necessary adaptations, references to a company to which section 245 of that Act applies or to an investment company being read as references to a close company and, in section 264(1), as extending to any company which appears to the Board to be a close company; and the powers conferred on the Board in relation to section 78 of this Act by the said sections 250(3) and 264 shall be exercisable by the inspector in relation to section 77 of this Act.
- 11 (1) A close company may, at any time after the general meeting at which the accounts for any period of account are adopted, forward to the inspector a copy of those accounts, together with a copy of the report, if any, of the directors for that period, and such further information, if any, as it may think fit, and may request the inspector to proceed under this paragraph in relation to any accounting period comprised in that period of account :

Provided that this sub-paragraph shall not apply if the company is neither a trading company nor a member of a trading group and has no estate or trading income.

- (2) Where the inspector receives a request made in accordance with sub-paragraph (1) above in relation to any accounting period, then subject to sub-paragraph (3) below he shall, within three months after receipt of the request, intimate to the company

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whether or not he proposes to make an assessment on the company in respect of the accounting period under section 77 of this Act.

- (3) On receiving a request made in accordance with sub-paragraph (1) above the inspector may, not later than three months after receipt of the request, call on the company to furnish him with such further particulars as he may reasonably require ; and if he does so, the time for giving the intimation required by sub-paragraph (2) above shall not expire before three months after he has been furnished with those particulars.
- (4) Where the inspector receives a request made in accordance with sub-paragraph (1) above in relation to any accounting period, and does not within the time limited by sub-paragraphs (2) and (3) intimate his intention to make an assessment in respect of the period, no such assessment shall be made unless either—
 - (a) the information accompanying the request, and any further particulars furnished to the inspector in connection therewith, are not such as to make full and accurate disclosure of all facts and considerations which are material to be known to the inspector ; or
 - (b) within twelve months of the end of the period paragraph 12 or 13 below has effect in relation to the company.

Cessation of trade and liquidations.

- 12 (1) Where a close company ceases to carry on the trade, or the business of holding investments, in which its activities wholly or mainly consisted, then, subject to sub-paragraph (2) below but notwithstanding any other provision limiting the required standard of distributions, the required standard for any accounting period in which that event occurs, or which ends in or with the twelve months ending with that event, shall be calculated on the whole, instead of sixty per cent., of the estate or trading income (if any) taken into account and without any deduction in respect of the requirements of the business.
- (2) Where sub-paragraph (1) above applies to an accounting period and the company shows that the company could not make distributions up to the required standard without prejudice to the claims of creditors (excluding those mentioned in sub-paragraph (3) below), then for purposes of section 77 of this Act so much of the shortfall as the company shows could not be avoided without prejudice to those claims shall be disregarded.

Where this sub-paragraph applies a reference to it shall be substituted in section 78(3) of this Act for the reference to section 77(4).

- (3) The creditors excluded for the purpose referred to in sub-paragraph (2) above are all participators and associates of participators, and all creditors in respect of debts originally created in favour of or due to a person who was then a participator or associate of a participator:

Provided that a creditor is not to be excluded in respect of any debt which either—

- (a) arose in the ordinary course of the company's trade or the company's business of holding investments and also in the ordinary course of a trade or profession of the creditor or, as the case may be, of the participator or associate who was the original creditor ; or
- (b) is a debt for remuneration chargeable to income tax under Schedule E; or

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- (c) is a debt for any rent or other payment due for the use of tangible property or of copyright in a literary, dramatic, musical or artistic work within the meaning of the Copyright Act 1956 (or any corresponding right under the law of a country to which that Act does not extend), and not representing more than a reasonable commercial consideration for that use.
- 13 (1) Paragraph 12 above shall apply where a resolution is passed or an order is made for the winding up of a close company, or where any other act is done for a like purpose in the case of a winding up otherwise than under the Companies Act 1948, as that paragraph applies in a case falling within sub-paragraph (1) of it.
- (2) Where an event mentioned in sub-paragraph (1) above occurs in the case of a close company, then any assessment on the company in respect of a shortfall in distributions for an accounting period which ends in or with the twelve months ending with that event, shall be an assessment as for a distribution made immediately before that event, and the amount due under the assessment shall be recoverable accordingly.
- (3) Where after any such event the company carries on a trade or a business of holding investments, then sections 77 and 78 of this Act shall, notwithstanding the winding up, continue to apply as if the company were not being wound up, and paragraph 12 above shall apply for any accounting period ending after the date of that event.

Transitional and consequential.

- 14 (1) Sections 77 and 78 of this Act shall not have effect as regards any accounting period or part of an accounting period falling before the beginning of the year 1966-67.
- (2) As regards income arising to a company before the end of the year 1965-66 Chapter III of Part IX of the Income Tax Act 1952 shall continue to have effect, and the income of a company to be taken into account under that Chapter shall include income chargeable to corporation tax, subject to the following provisions:—
- (a) in deciding under section 245 whether a company has distributed a reasonable part of its actual income account may be taken of amounts treated under paragraph 9 above as distributions for a period after the end of the year 1965-66, but only to the extent to which they exceed the required standard ; and
 - (b) section 249(5) shall have effect subject to the like limitation as is imposed by section 78(7)(d) of this Act for purposes of section 78.
- (3) Where a period of account or an accounting period of a company falls partly in the year 1965-66, and partly in the year 1966-67, the two parts shall for purposes of the said Chapter III or, as the case may be, the said sections of this Act be dealt with as separate accounting periods:

Provided that—

- (a) where under paragraph 9(2) above it is necessary to apportion any dividends treated as dividends for any such period of account, it shall be done according to the proportion which the income of the part falling in the year 1965-66, computed as for the said Chapter III (but less income tax at the standard rate), bears to the distributable income for the part falling in the year 1966-67 ; and
- (b) where the distributions for any such accounting period are to be treated as including any amount in respect of the directors' remuneration, then—

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- (i) in the case of a trading company, that amount shall be apportioned between the two parts of the period, and the amount apportioned to the earlier may be treated for purposes of the said Chapter III as income distributed by the company;
 - (ii) in the case of a company other than a trading company, the whole amount shall be taken into account in the part of the period falling in the year 1966-67.
- 15 (1) In relation to income arising in or after the year 1966-67 section 411(1)(b) of the Income Tax Act 1952 (which defines " income arising under a settlement " for certain purposes relating to revocable settlements etc.) shall have effect with the substitution for the reference to Chapter III of Part IX of that Act of a reference to section 78 of this Act; and in relation to that and subsequent years of assessment there shall be substituted for subsection (4) of that section—
 - “(4) For the purposes of this Chapter, a body corporate shall be deemed to be connected with a settlement in any year of assessment if, within the meaning of Part IV of the Finance Act 1965, it is at any time in the year a close company (or only not a close company because it is not resident in the United Kingdom) and the participators then include the trustees of or a beneficiary under the settlement.”
- (2) In relation to the year 1966-67 and later years of assessment—
 - (a) in section 412(8)(d) of the Income Tax Act 1952 (which provides for amounts apportioned to a person under Chapter III of Part IX of that Act to be treated as his income for certain purposes) for the words " Chapter III of Part IX of this Act" there shall be substituted the words " section 78 of the Finance Act 1965 "; and
 - (b) in section 414(4) of that Act (which relates to the information a solicitor may be required to furnish under that section about transactions resulting in transfers of income to persons abroad) for the words from " The bodies corporate " onwards there shall be substituted the words—
 - “The bodies corporate mentioned in the preceding provisions of this section are bodies corporate resident or incorporated outside the United Kingdom which are, or if resident in the United Kingdom would be, close Companies, but not trading companies, within the meaning of Part IV of the Finance Act 1965.”.
- (3) Any amount apportioned under section 78 of this Act to the personal representatives of a deceased person shall be treated as included as regards surtax in the aggregate income of the estate for purposes of Part XIX of the Income Tax Act 1952.