

## Associated Companies and the Marginal Rate

In between the small profits rate of corporation tax (20%) which applies up to profits of £300,000 and the main rate (26%) which applies to profits over £1,500,000, lies the 'marginal rate zone'. This is the band where an effective composite rate of 27.5% is applied to ensure a smooth transition between the 20% and 26% thresholds. This can be demonstrated by calculating the tax at different levels of profit:

Profit	£600,000	£900,000	£1,200,000	£1,500,000
£300,000 at 20%	£60,000	£60,000	£60,000	£60,000
Balance at 27.5%	<u>£ 82,500</u>	<u>£165,000</u>	<u>£247,500</u>	<u>£330,000</u>
	<u>£142,500</u>	<u>£225,000</u>	<u>£307,500</u>	<u>£390,000</u>
<b>Overall rate of tax</b>	<b>23.75%</b>	<b>25%</b>	<b>25.625%</b>	<b>26%</b>

Companies are understandably anxious to avoid having any of their profits tripping over the £300,000 threshold and therefore being taxed at the marginal rate of 27.5%. Some time may be spent in attempting to control the timing of sales and expenses, especially near the accounting year end.

The thresholds are annual limits and they are scaled down for accounting periods of less than a year, but they are also scaled down if there are 'associated companies' carrying on any trade or business at any time during the accounting period.

If the company has one associated company, then the thresholds are halved with the lower limit becoming £150,000 (and the higher limit £750,000). For companies with two associated companies the thresholds are divided by three and the lower limit reduces to £100,000, and so on.

This can present real problems when the companies are likely to have fundamentally different profit levels. So, for example, three companies associated with each other could have profits totalling £270,000, split as follows:

Profit	£20,000	£200,000	£50,000
First £100,000 at 20%	£4,000	£20,000	£10,000
Balance at 27.5%	<u>£ -</u>	<u>£27,500</u>	<u>£ -</u>
<b>Tax</b>	<b><u>£4,000</u></b>	<b><u>£47,500</u></b>	<b><u>£10,000</u></b>

The total tax is £61,500, compared with a single company paying £54,000 on profits of £270,000.

So what are associated companies? They may be either members of the same group or companies controlled by the same persons.

With effect for company accounting periods ending on or after 1 April 2011, companies will no longer be held to be associated by mere accident of circumstances. They will be treated as under common control (and thus associated) only where substantial commercial interdependence exists between them.

The moral of all this is ‘think twice before you set up a lot of separate companies’. There may be compelling reasons for doing so, but it’s worth considering operating a number of ‘divisions’ within a single company.

**Do call us if you would like further help or advice in this area.**