PKF FRANCISCLARK

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An Introduction to:
Changes to Corporate Loss Relief

Introduction

As part of the UK Government's 'business roadmap' there will be some significant changes to the corporate tax loss relief system from 1 April 2017.

Historically profits and losses were reported on a schedular basis, with different types of profits and losses generally kept separate in terms of offset, particularly once they were carried forwards. From a group perspective once losses were carried forwards generally speaking they could only be used by the same company. Whilst the schedular system itself was dismantled some years back the underlying mechanics were not.

The clear problem with this was that loss making groups could end up with a tax charge because one company was profitable with stranded losses sat within another group company unavailable for offset. It was concluded that this no longer represented a fair basis of taxation.

At the same time it was felt that companies with large pots of losses should not be able to use them without restriction. In other jurisdictions brought forwards losses are often time restricted (i.e. must be used within a certain period), or the amount of losses available to be used is limited in some way. The price to pay for the improved loss offset system therefore is a restriction on the use of brought forwards losses in certain circumstances.

The Headline Changes

a) Losses arising after 1 April 2017 will be pooled so that all types of losses across all group companies can be set against all types of profit across all group companies.

b) Where losses carried forwards are to be used to offset more than £5m of current year profit there will be a restriction. This restriction will be 50% of the losses used above the £5m allowance.

c) All losses incurred pre 1 April 2017 will be subject to the existing restrictions on use and offset.

The definition of 'group' will be broadly the same as the current definition for group relief – i.e. 75% of ordinary share capital required.

Capital gains and losses are excluded from these changes and remain separate.

The rules include a change of ownership provision denying group relief for pre-acquisition losses in situations where has been a 'major change' in the nature or conduct of the trade. Similar provisions are included where a trade or investment business becomes 'small or negligible'.

The rules also now include a targeted anti-avoidance provision seeking to counteract tax driven arrangements aimed at 'circumventing the limits of relief' under the new rules or those 'exploiting shortcomings' in the legislation.

The Mechanics

The basic simplified calculation is as follows:

a) Determine trading and non-trading profits of the entity and deduct from this number all current year loss reliefs, plus the relevant proportion of the £5m allowance in whatever manner chosen;

b) To the extent that taxable profit exceeds £5m, allow up to 50% of the excess profit to be offset by brought forwards pre 1 April 2017 losses on a streamed basis;

c) Allow any remaining amount of up to 50% of combined profits to be offset by brought forwards post 1 April 2017 losses within the entity, or any further available offsettable profit in other group companies.

In Practice

Segregating losses pre and post 1 April 2017, and then working out which losses can be group relieved once carried forwards and which can't is likely to lead to considerable additional compliance burden, particularly where complex group structures exist, and where accounting periods straddle 1 April 2017.

Of course for those companies with material amounts of pre 1 April 2017 losses there remains the possibility of stranded losses. Where losses become stranded it used to be possible to undertake planning to 'refresh' them – however in 2015 HM Treasury introduced 'anti-loss refresh rules' to prevent this.

For smaller groups with losses of around £5m or less the £5m allowance will ensure that they see no or limited restriction, with the ability to offset all post 1 April 2017 losses across the group going forwards.

Those groups with significant initial investment and corresponding losses arising may find themselves with limited access to losses brought forwards, as will those businesses who are ordinarily profitable but find themselves with one bad year of trading.

It has to be said that the actual operation of the rules is likely to be complex and groups may find that unexpected outcomes arise once the numbers are crunched - as a result groups will need to model the position carefully and establish whether there are any specific actions which they can take to improve their position.

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