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Carried Forward Losses for Companies

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BACKGROUND (CARRIED FORWARD LOSS RULES PRE - 1 APRIL 2017)

Prior to 1 April 2017, relief for carried-forward losses for companies was much more restricted than relief for losses arising in the current tax period.

In the current tax period, losses could generally be set against other forms of profits ("sideways loss relief") and also relieved against profits in other group companies ("group relief").

For carried-forward losses, the relief available depended on the type of loss - trading losses, non-trading loan relationship deficits, property business losses, excess management expenses and capital losses, all had different rules in terms of how they could be utilised. Group relief was not available for carried-forward losses.

The most common type of carried-forward loss, trading losses, could only be offset against future profits from the same trade in the same company. This commonly resulted in a corporation tax liability arising where a company had an overall loss for accounting purposes, but non-trading income (eg bank interest) for tax purposes.

It is important to note that these rules still apply for losses generated prior to 1 April 2017 but carried into subsequent periods.

EXAMPLE OF PRE-1 APRIL 2017 RULES

A company has brought forward pre-1 April 2017 trading losses of £50,000, current year non-trading loan relationship profits of £25,000 and current year trading profits of £5,000. Under the old rules tax would be due on the £25,000 non-trading loan relationship profit and a trading loss of £45,000 would be carried forward.

NEW FLEXIBILITY (LOSSES ARISING POST-1 APRIL 2017)

The good news is that for losses arising after 1 April 2017 there is much more flexibility when utilising carried forward losses. The exception to this is capital losses which do not fall under the scope of the changes and will continue to only be available to offset against capital gains. Where we refer to losses in the rest of this article we are referring to all losses except for capital losses and those subject to restrictions (see below).

Carried forward losses that arose prior to 1 April 2017 will fall under the old rules and restrictions and only losses arising after 1 April 2017 will be subject to the new rules. For accounting periods straddling this date (e.g. an accounting period of the year ended 31 December 2017) losses are split into pre and post 1 April 2017 losses on a pro-rata basis, unless this results in an unfair apportionment.

The new flexible rules applying to post 1 April 2017 carried forward losses are:

- Losses carried forward can be offset against any type of profits in the same company.
- Losses carried forward can be surrendered to other group companies in the same 75% group via group relief and relieved against any type of profits of group companies.

EXAMPLE OF POST-1 APRIL 2017 RULES

A company has brought forward post 1 April 2017 trading losses of £50,000 and current year non-trading loan relationship profits of £25,000 and current year trading profit of £5,000. Under the new rules no tax is due and a trading loss of £20,000 is carried forward.

RESTRICTIONS

It should be noted that there are some instances where the new more flexible loss rules will not apply and losses will be streamed in a similar manner to the old rules. This is by no means a full list but the main restricted losses are:

- A trade wholly outside of UK
- Trade not commercial and with view to a profit
- Trade or investment business considered to have ceased or become small/negligible
- Long-term farming losses
- Certain dealings in commodity futures
- Various provisions related to creative arts.

RESTRICTION FOR GROUPS WHERE LOSS RELIEF EXCEEDS £5 MILLION

There is a group wide restriction of £5million of carried forward losses being utilised per group per year. Where this threshold is breached then only 50% of the remaining profits in the group can be utilised by carried forward losses.

The group has flexibility around how it decides to surrender its losses.

For these purposes the definition of 'group' follows the group relief definition of group, which is broadly at least a 75% direct interest between the entities.

EXAMPLE OF RESTRICTION

Company A has brought forward post 1 April 2017 trading losses of £10million and current year profits of £5million and Company B (which is a member of the same 75% group relief group) has current year profits of £3million.

Company A can utilise £5million of its brought forward losses against its own profits to reduce the taxable profit to nil. It can then utilise losses against 50% of Company B's profits i.e. surrender £1.5million of brought forward losses to Company B. This results in taxable profits of £1.5million in Company B and £3.5million post 1 April 2017 trading losses being carried forward in Company A.

IMPACT ON DEFERRED TAX AND CASH FLOW FORECASTS

The new loss rules are likely to mean that losses will be utilised sooner than under the old rules for smaller companies and groups (those where loss relief does not exceed £5million). This will need to be considered in respect of deferred tax calculations and cash flow forecasts. Deferred tax calculations will need to consider the tax rate applying in the year in which the losses are expected to be utilised. Cash flow forecasts will need to consider how the new rules will impact on expected tax liabilities to HMRC and payments for group relief (if made).

Larger companies and groups (which exceed the £5million loss relief threshold) will also need to take into account the loss restriction in their deferred tax calculations and cash flow forecasts.

SUMMARY

The new rules are very welcome, as they will provide increased flexibility for the relief of carried forward losses, both for standalone companies and those in a group.

The devil is in the detail (there are nearly 100 pages of legislation), especially in terms of when restrictions apply and it is recommended that each company considers the impact of the new rules on their tax computations, accounts and cash flows.

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