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DRAFT FINANCE BILL CLAUSES: REFORMS TO CORPORATION TAX LOSS RELIEF

Despite calls from some to slow down the pace of reform following the EU Referendum vote, the Government is pressing ahead with its corporation tax reforms. These include the proposals for the reform of the corporation tax loss regime announced at the time of the last Budget, details of which were published in a consultation paper on 26 May 2016.

The draft Finance Bill clauses published on 5 December 2016 include the draft provisions to implement some (but not all) of the proposed changes.

THE MAY 2016 CONSULTATION

By way of reminder, the May 2016 consultation paper set out three main proposals:

- to allow the carry forward of losses (other than capital losses) arising after 1 April 2017 against taxable profits of different activities (and so relax some of the restrictions inherited from the old schedular system);
- to allow carried forward losses arising after 1 April 2017 to be made available by way of group relief to other members of a group; and
- to restrict the amount the amount of taxable profits that can be sheltered by carried forward losses to 50 per cent. of the taxable profits in excess of an allowance of £5m per group of companies.

THE DRAFT FINANCE BILL CLAUSES

The main elements of the May 2016 proposals are retained in the draft legislation.

Relaxations and clarifications

There are, however, some significant relaxations and clarifications.

- The proposed model of the legislation in the May 2016 consultation paper was overly-complicated. For post-April 2017 periods, it required total reliefs for a period to be off-set proportionately between trading and non-trading profits before applying the carry forward rules. It also retained a hierarchy of losses by requiring a company's carried forward losses arising due to excess management expenses, UK property losses and non-trading losses on intangible fixed assets to be used in priority to carried forward trading losses and non-trading loan relationship deficits. These rather unnecessary complications in the proposed rules are being abandoned. This will allow companies and groups much greater flexibility in the proposed use of post-April 2017 losses.
- The distinction between pre-April 2017 and post-April 2017 losses will be retained, with the old restrictions continuing to apply to pre-April 2017 losses. However, in a further relaxation, the requirement in the May 2016 proposals for pre-April 2017 losses to be used in priority to any post-April 2017 losses is being dropped. Companies will also be able to elect for the automatic set-off of pre-April 2017 carried forward trading losses against profits of the same trade in the next accounting period not to apply, but instead for those losses to carry forward to a later period. The combination of these changes will enable companies to choose whether or not to use pre-April 2017 losses before other available losses.
- A simplified calculation will be made available for companies who do not have (or elect not to use) any pre-April 2017 trading losses or pre-April 2017 non-trading loan relationship deficits in a given accounting period.
- Losses will not automatically evaporate when a company goes into liquidation.
- Corporate groups will be allowed to allocate the £5m annual allowance between group members at their discretion. The definition of group will now be based on the definition used for group relief purposes, but with additional provisions to prevent fragmentation of existing groups in order to claim more than one £5m allowance.

Unintended consequences: fixed term investment projects

The Government has recognised that the proposed limits on the use of carried forward losses could have had significant effects on fixed term investment projects which make large up-front losses but which generate profits towards the end of the project.

- The Government is proposing to address this issue by allowing any carried forward losses which remain unused when a trade ceases to be carried back against profits for the final 36 months of trading without limit (i.e. without being subject to the £5m cap or 50% restriction above profits of £5m) provided that the profits arise after 1 April 2017. For post-April 2017 losses, the carry back will be allowed against total profits. For pre-April 2017, the carry back will only be permitted against profits of the same trade.

More anti-avoidance rules

The revised proposals also contain plans for a multitude of additional anti-avoidance rules, which have yet to be drafted. These will include:

- new rules to prevent the surrender of pre-acquisition carried forward losses to members of a new group for a period of five years after a company joins a new group;
- the extension of the existing restrictions on the use of losses following a change of ownership so that the relevant conditions will have to be met for a five-year period (as compared with the current three-year period) and to restrict the use of losses if the nature or conduct of a business changes within five years of a change in ownership (i.e. not just where there is a major change);
- new rules to re-impose the streaming of losses if a business becomes small or negligible (e.g. if a trade becomes small or negligible, any carried forward trading losses will only be available for set off against profits of the same trade); and
- new rules to prevent the refreshing of losses by converting carried forward losses into in-year losses which will extend not just to trading losses but to other losses as well;
- the introduction of regime-wide TAAR.

OTHER ISSUES

The rules will remain very complicated for banks to apply as they will still have to manage the combined effect of the new rules and the separate regime which applies to losses accruing prior to April 2015. In addition, the Government has also decided not to respond to pleas from the insurance industry to address the effect of the proposals on their regulatory capital position.

Furthermore, even after the proposed changes, the new regime will be a net cost to larger corporate groups. The figures published by HMRC at the time of the draft Finance Bill clauses predict that the effect of the new rules will be to increase the tax take by amounts ranging between roughly £250m and £400m in each of the first four years after their introduction.

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