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Corporate loss tax rules could be double edged sword

Menzies tax manager Natasha Spicer and tax director Lucy Mangan consider the impact of changes to the tax regime for corporate losses with the introduction of rules to curb corporate use of interest deductibility

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New rules affecting the way that corporate losses can be utilised could be beneficial for many businesses, while potentially bringing challenges for some larger companies. In order to provide the right advice, accountants need to be aware of exactly how the changes will impact all of their clients – large and small.

The Finance Bill (No.2) 2017 includes not one but two quite substantial changes which effect how losses can be used. These changes come into effect from 1 April 2017 potentially therefore having an impact on a company's current year.

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The relaxation

The first change will increase flexibility and is to be welcomed. But note – this only applies to losses incurred after 1 April 2017.

Historically losses which were not utilised in the year incurred could be carried forward but how they could be utilised in future depended on the nature of the loss and no group relief was available in later years. This will remain the case for unutilised losses arising prior to 1 April 2017.

Moving forward, losses (including trade losses, loan relationship deficits, property losses, excess management charges) sustained on or after 1 April 2017, that cannot be utilised in the current year, can be carried forward and offset against any profits arising in the company in future years, and possibly group relieved too. It is important to note that this does not apply to capital losses.

The more flexible offset of corporate losses will allow all companies and groups to have more of a say in their own tax calculations and will minimise the risk of losses getting trapped as can currently be the case.

All companies may therefore benefit from this change.

The restriction

The second change introduces a potential restriction on the amount of profits that can be reduced by losses which have been carried forward from earlier years.

This change also comes into effect from 1 April 2017 but importantly this change applies to all losses regardless of when they were incurred. Therefore, all losses that have not been utilised at 1 April 2017 will fall within these rules.

Effectively under the rules UK groups (or companies if stand-alone) will be given a £5m annual allowance and profits (after any current year loss offset), up to this amount can be offset in full. For profits over £5m, the restriction will come into play and only 50% of any remaining profits can be reduced by losses brought forward.

Groups or stand-alone companies with less than £5m of unused losses will not need to worry about any restriction.

However, groups or companies that have built up large losses and may have taxable profits in a later year of more than £5m could be impacted. Overall this may only be a timing difference as losses can be carried forward and used in later years, however it could have a substantial impact on cash flow.

If companies fail to plan appropriately, they could be faced with a large, unexpected tax bill. (£190,000 in the below example). It may also impact the required timing of any corporation tax payments.

To illustrate the changes, see example below:

Rules	Old rules	New rules
Taxable profits y/e 31 March 2018	£7m	£7m
Offset of losses brought forward	(£7m)	(£6m)*
Taxable profits	£nil	£1m
Tax @ 19%	£nil	£190,000

Losses brought forward prior year	£10m	£10m
Offset against current year profits	£7m	£6m
Losses carried down	£3m	£4m
*(£5m plus 50% of remaining £2m)		

What should companies do?

While the changes have been well trailed companies may not have fully considered the rules and understood the potential impact on their business. To avoid unexpected tax liabilities or cash flow implications and ensure losses are utilised most effectively companies should review their current and expected loss position and seek advice as required.

About the authors

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