

Corporate capital loss restriction

(Lecture B1148 – 14.58 minutes)

The Government's plan

In his most recent Budget, the Chancellor announced the Government's intention to reform the rules for the relief of corporate capital losses with effect from 1 April 2020. The rationale behind this measure is to, in HMRC's words, 'extend the corporate income loss restriction (CILR) introduced in April 2017 to include carried-forward capital losses and help create a more modern loss relief regime in the UK'. The basic principle is that companies making capital gains will only be able to use carried-forward capital losses to offset up to 50% of those gains.

However, in order to ensure that the new restriction only impacts on those companies with substantial gains, the plan is to widen the deductions allowance of £5,000,000, which was originally provided just for the CILR, to cover capital losses as well. As a result, the vast majority of companies should be unaffected financially by this restriction. Note that there will not be a separate £5,000,000 allowance – it will encompass both trading and capital losses that are carried forward.

The present regime

At present, capital losses that accrue to a company in an accounting period are set against capital gains arising in the same period. Where gains exceed losses in an accounting period, the company has chargeable gains that are subject to corporation tax. Where losses exceed gains (or where there are no gains), the UK tax system has hitherto allowed the unrelieved losses to be carried forward indefinitely and set against gains arising in future years as and when they are made.

Another relevant provision is that companies within a 75% group for capital gains purposes can elect to transfer gains or losses which arise or accrue in an accounting period to another member of that 75% group (S171A TCGA 1992).

Reform

Enabling companies to claim relief for capital losses carried forward from previous accounting periods is an important feature of the corporate capital gains system, ensuring that the tax paid by a company is reflective of its net capital gains position over the long term.

However, the Government believe that the existing corporate capital loss rules are not consistent with the CILR measures for other corporate losses. Consequently, they argue that there is a case for alignment. In particular, the CILR legislation in F(No2)A 2017 benefits capital gains of a company by allowing carried-forward losses – and trading losses, in particular – to be set against capital gains.

HMRC go on to say:

‘The absence of any restriction on the amount of capital gains that can be relieved by carried-forward capital losses can also have undesirable outcomes for the Exchequer, as businesses making substantial capital gains over many years may not pay any corporation tax due to losses incurred from historic disposals.’

The Government now propose a major reform of corporate capital losses in order to address this so that:

(i) the amount of capital gains that can be relieved by carried-forward capital losses will be limited to 50% from 1 April 2020; and

(ii) the allowance of £5,000,000 per group . . . introduced for CILR will also cover capital gains that can be offset with carried-forward capital losses.

Once introduced, these reforms will bring the treatment of capital losses closer to other corporate losses.’

It is understood that ‘significant’ amounts of carried-forward corporate capital losses predate some of the recent changes to the capital gains regime for companies such as the establishment of the SSE and the intangible fixed asset rules. The Government consider that limiting the capital gains that can be relieved with carried-forward capital losses will help to address this situation in a way which is consistent with the CILR.

Of course, where a company’s capital losses are restricted, it will still be possible to carry forward any unutilised capital losses and set these against capital gains arising in later accounting periods.

In the event of the restriction being in point and where an election has been made to transfer capital gains between two members of a 75% group in order to access carried-forward capital losses in the transferee company, the 50% restriction will be applied to the capital gains transferred under that election.

Note that the Government intend to ensure that in-year capital losses are always able to be set off in full against a company’s capital gains. In other words, the 50% restriction will never be implemented in this situation. However, if there are also carried-forward capital losses, the new rule can be applied to the company’s net capital gains.

The steps to be taken

Where the carried-forward losses relate to a singleton company, the position is reasonably straightforward. The main decision that will need to be made is how the deductions allowance of £5,000,000 should be split between the company’s capital losses and – usually – the company’s trading losses. However, for groups of companies, the calculation becomes more complicated. The steps set out in (m) below show how this might be done.

There are five steps to the process:

1. Allocate the £5,000,000 group deductions allowance – the group is free to decide how much of this allowance should be allocated to the capital loss restriction (where there is more than one type of loss carry-forward);

2. Perform the CILR computation – the group will calculate the amount of the loss restriction required for each company under the CILR rules and the quantum of the deductions allowance used here will of course be limited to the amount not allocated to the capital loss restriction;
3. Allocate the deductions allowance to the net capital gains. Each company will calculate the net gains of the year after taking into account all in-year reliefs and the effect of any election under S171A TCGA 1992. In-year reliefs already dealt with in the CILR computations are ignored. The company must also disregard any gains to the extent that they are used as part of the CILR computations in (ii) above. The total of gains which can be relieved in full by carried-forward losses is the amount of the deductions allowance allocated to the company;
4. Calculate the maximum amount of carried-forward losses which can be set against gains – 50% of any gains which are left over after (iii) above plus gains equivalent to the allocated deductions allowance may be relieved by carried-forward losses (this assumes that sufficient losses are available);
5. Allocate carried-forward losses against capital gains. The company can choose which type of carried-forward losses are set against the amount of gains calculated in (iv) above. Once this has been done, the company's profits chargeable to corporation tax can be computed in the normal way.

Anti-avoidance

As would be expected nowadays, the legislation will include an anti-forestalling measure and other anti-avoidance rules to ensure that, in HMRC's words, 'this reform is robust against avoidance or abuse'. For example, bed and breakfasting an asset before 1 April 2020 could have the effect of crystallising a large capital gain, which is then fully sheltered by carried-forward capital losses, with the reacquired asset having a higher base cost. This is the sort of transaction that would be caught.

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