

Finance Bill: Corporate capital loss restriction

(Lecture B1198 – 28.06 minutes)

From 1 April 2020, there is a potential restriction on the proportion of annual chargeable gains that can be relieved by brought-forward capital losses. This is an extension of the 2017 provisions relating to other corporate losses. The legislation is at Clause 24, introducing Sch.3 of the Finance Bill.

The £5 million deductions allowance (group-wide) which has been claimable since 2017 in relation to other deficits can be used by capital or income losses each year at company's behest.

The company/group needs to specify how much deductions allowance it wants to allocate to trading profits (the "trading profits deduction allowance"), how much it wants to allocate to non-trading income profits ("the non-trading income profits deduction allowance") and how much it wants to allocate to capital gains ("the chargeable gains deduction allowance").

Example

A company has brought forward corporate capital losses of £2.4 million and trading losses of £3.1 million from its accounting period ending 31 March 2020.

In the year ended 31 March 2021 it makes a taxable trading profit of £3.2 million and has a chargeable gain of £2.3 million.

Explain how it can utilise its available losses.

Solution

The company should claim the full £5m deductions allowance.

As capital losses can only be relieved against chargeable gains, it should first allocate £2.3m of the allowance to its gain for 2021 of £2.4m. This allows the maximum use of its brought forward capital loss of £2.4m.

It will offset £2.3m of this loss against the gain, leaving a capital loss to carry forward against future chargeable gains of £100,000.

The other £2.7m of the deductions allowance should be allocated to trading profits.

The trading losses brought forward of £3.1 million will be offset as follows:

- £2.7m @ 100% plus
- (£3.2m – £2.7m) @ 50%
- i.e. £2.95 million

This leaves £150,000 of trading losses to carry forward which can be offset against all future profits including chargeable gains (subject to the cap).

Companies in insolvent liquidation

If a company has gone into an insolvent liquidation or a corresponding situation outside the UK, its deductions allowance for a winding-up accounting period is increased by the smaller of its net gains for the period, or its allowable losses brought forward.

Gains on assets disposed of that were received from non-insolvent 75% group companies at no gain/no loss (or where a s171A TCGA election has been made to deem the asset to have been transferred to the insolvent company prior to disposal) are not included in determining the insolvent company's net chargeable gains in a winding up period.

This is to prevent groups gaining a tax advantage by routing all disposals through an insolvent member of the group to avoid the restriction on the set-off of losses brought forward.

This effectively means that the insolvent company can use all of its capital losses brought forward to relieve current year net gains.

In its CT600, the company would need to specify what deductions allowance would have applied if it was not in insolvent liquidation.

Companies with no source of chargeable income

If a company is only chargeable to corporation tax on a chargeable gain from the disposal of an asset (e.g. a non-resident company disposing of a UK property), it may only have a one-day chargeable accounting period.

This would ordinarily mean that its deductions allowance would be restricted to (1/365ths of £5 million) £13,699.

The company can, however, make a claim in this case to take advantage of the full £5 million allowance (or any part of it, as necessary) but if it is a member of a 75% group, then no company in the group must have any income chargeable to corporation tax in the financial year (but they can have gains chargeable on disposal of assets).

The claim must be made within two years of the end of the accounting period but cannot be made before the end of the financial year (i.e. 31 March following the date of disposal).

If a company delivers its CT600 to declare a chargeable gain before the end of the financial year, it can make a declaration in the return that at all times earlier in the same financial year that neither it, nor any group company, had no sources of chargeable income and that intends to make a claim for the full deductions allowance after the end of the financial year.

The declaration is treated as if it had made the claim and it can use the £5 million deduction allowance in the tax calculation.

The declaration ceases to have effect if it is withdrawn, is superseded by an actual claim, or another group company acquires a source of chargeable income before the end of the financial year. If none of these happen within two years of the end of the chargeable accounting period, the declaration ceases to have effect and the tax must be recalculated.

The normal rules on allocating a deductions allowance around the group do not apply in these circumstances.

This would seem to indicate that if (say) two companies in the same group had chargeable gains, where no member of the group had a source chargeable to income tax (i.e. they both had one-day chargeable accounting periods), both would be entitled to claim a deductions allowance of £5 million.

Companies with no source of chargeable income – carry back of losses

A company that has no source of income chargeable to UK corporation tax but realises chargeable gains or allowable losses on asset disposals could have more than one separate (one-day) chargeable accounting period in a financial year.

Finance Bill 2020 amends s2A TCGA 1992 to allow a capital loss in a later accounting period to be set off against a chargeable gain in an earlier accounting period falling in the same financial year.

Example

A Jersey resident company has no permanent establishment in the UK, no UK property business and no trade or dealing in UK land.

It has held two pieces of land in the UK for many years. Both are currently active general aviation airfields.

Airfield 1 has planning permission to develop housing, but Airfield 2 has just been refused planning permission at an appeal hearing.

The company has decided to sell both pieces of land.

On 27 September 2020 it exchanges contracts on Airfield 1, realising a chargeable gain of £5,754,205.

It is in negotiations to sell Airfield 2 and hopes to exchange contracts in late March 2021 or early April 2021. Based on the prices being offered, the company expects to realise a capital loss of £2,450,000.

What are the tax implications of the timing of the disposal of Airfield 2?

Analysis

If Airfield 2 is sold before 1 April 2021, the loss can be offset against the gain arising on 27 September 2020. There would be two separate one-day accounting periods and both would fall in the same financial year.

If Airfield 2 is sold on or after 1 April 2021, the loss would have to be carried forward for relief against any future chargeable gains as it would fall outside the financial year when the gain on Airfield 1 was realised.

If the company has no other UK assets that could give rise to a chargeable gain, it might be preferable to discount the selling price of Airfield 2 to expedite a disposal before 1 April 2021 and ensure that the loss saves corporation tax at 19% against the gain on Airfield 1.

Clogged losses

Allowable losses a company incurs on disposals to a connected person can only be relieved against disposals to the same person in the same or a future accounting period (s18 TCGA 1992).

Finance Bill 2020 allows a company to claim in its CT600 to deduct brought-forward clogged losses in preference to losses that arise in the period, but only where the carried forward clogged losses could have been offset if the capital loss restriction did not apply.

The amount of clogged losses used must not exceed the amount of allowable losses arising in the period for which the claim is made. Effectively, the two losses swap over with each other and there is nothing in FB2020 to then stop the use of brought forward losses in the normal way.

Example

A company has a current year related party gain of £20 million, a current year loss (3rd party) of £6 million, and a brought forward clogged loss from a transaction with the same related party of £10m.

Analysis

The current year net gain position becomes:

Connected party gain	£20m
Clogged loss b/fwd treated as current year loss	<u>(£6m)</u>
	<u>£14m</u>

Brought forward losses are (the 3rd party loss switched) of £6m plus remaining clogged losses of £4m (10m – 6m used above) = £10m

Set off of b/fwd capital losses is restricted to £5m (if claiming deductions allowance against gains) + 50% x (14m – 5m) i.e. £9.5m.

So, the net gain of £14m after current year loss relief can be reduced by £9.5m for brought forward capital losses.

No order of set offset seems to be specified so it seems that the company can nominate that the £0.5m of as yet unrelieved capital loss to carry forward is an unclogged loss.

Pre-entry losses

Finance Bill 2020 amends the rules on the use of pre-entry losses to bring them within the capping regime.

Realised capital losses of a company from before it joins a group cannot be used to shelter the gains of assets owned by the pre-existing members of the group. They can only be used to reduce gains on disposals by the company joining the group on assets it purchased or later purchases from third parties.

The amendment ensures that the maximum set off of capital losses brought forward is still limited to the capital gains deduction allowance plus 50% of any remaining gains, even where pre-entry losses are being brought forward.

Commencement rules

Accounting periods that straddle 1 April 2020 must be broken down into two separate periods for the purpose of determining the amount of capital losses brought forward that can be offset.

Capital losses in either part of the two periods can be offset against chargeable gains in either part of the two periods without restriction.

No restriction will apply to a non-resident company with a UK property business that realises an allowable loss between 1 and 5 April 2020 falling under corporation tax rules (but is within the charge to income tax on its property income for that period).

Where the company becomes chargeable to corporation tax for the period commencing 6 April 2020, and realises a gain in this period, the losses from disposals between 1 and 5 April 2020 can be fully offset against chargeable gains in the period commencing 6 April 2020.

It is also clarified that the non-resident company has a deductions allowance for its chargeable accounting period commencing 6 April 2020 but that this must be reduced for any deductions allowance claimed in any accounting period occurring between 1 and 5 April 2020.

Anti-forestalling rule

Where a company enters into arrangements

1. either between 29 October 2018 and 1 April 2020, or
2. in the pre-1 April 2020 part of an accounting period straddling that date

with a main purpose of securing a tax advantage under the corporate capital loss restriction rules before it comes into force, the carried-forward allowable losses are restricted to a maximum of 50% of the qualifying chargeable gains. No deductions allowance is available where this applies.