

Unincorporated businesses' losses

(Lectures B1212/ 1213 – 15.11/10.51 minutes)

With the economy hit hard by COVID-19, many unincorporated businesses will make losses this year, perhaps for the first time. A sole trader has great flexibility in how losses can be used (see below) and these rules also extend to members of partnerships and LLPs, subject to restrictions for non-active partners and limited partners (not covered in this article).

The default position

S.83 ITA 2007 allows a trading loss not used in any other way to be automatically carried forward to set against the first available profits of the same trade. As this only gives potential relief against one source of income in the future, rather than any immediate tax saving, it is usually the option of last resort. Of course, some businesses currently will be wondering if they will ever make profits again.

Terminal loss relief

Some business owners will not want to risk further capital by continuing to trade in the post COVID-19 world. If the trade ceases, terminal loss relief (s.89 ITA 2007) allows the loss incurred in the final twelve months of trade to be set against trading profits of the three tax years before the tax year of cessation, on a LIFO basis. This may generate large tax repayments if the trade has previously made significant profits.

Example - Vince

Vince ceased trading on 30 June 2020 after being in business for many years.

His adjusted results in recent years are as follows:

	£
Y/e 31.12.17	12,000
Y/e 31.12.18	1,800
Y/e 31.12.19	8,000
6m to 30.6.20	(13,000)

He has rental income of £5,000 p.a. The overlap profits on commencement were £2,000.

Analysis of final 12 months

[NB This is, in practice, done on a strict day-count basis, but here calculations are done to the nearest month for ease of explanation]:

	£
2020/21 (3m: 6.4.20 – 30.6.20)	
Unrelieved trading loss = $(3/6) \times (13,000)$	(6,500)
Overlap relief	(2,000)
2019/20 (9m: 1.7.19 – 5.4.20)	
$[(6/12) \times 8,000] + [(3/6) \times (13,000)]$	<u>(2,500)</u>
Terminal loss	<u>(11,000)</u>

If a claim is made, this would be used against trading profits, as follows:

	£
Terminal loss	11,000
2019/20	<u>(8,000)</u>
	3,000
2018/19	<u>(1,800)</u>
	1,200
2017/18	<u>(1,200)</u>
	<u>Nil</u>

Much of this loss claim will not save tax, due to the level of his income in years other than 2017/18.

Note that the time limit for a s.89 relief claim is 4 years from the end of the tax year in which the trade ceased (e.g. 5 April 2025 for a cessation in 2020/21).

Early year losses

Where a loss is incurred in any of the first four tax years of trade, s.72 ITA 2007 allows that loss to be carried back and used in the three tax years before the year of the loss, on a FIFO basis. Key technical points of such claims are:

The available loss for each tax year is established using the same rules as for profits (i.e. normal opening year rules).

If periods overlap, the loss is given only in the earlier tax year (i.e. there is no double counting of losses, in contrast to what happens with profitable basis periods).

The loss is set against total income, before deducting the personal allowance.

You must relieve all three previous years if there is enough loss (i.e. you cannot choose one particular year in which to set the loss off).

The maximum possible loss must be set off in each year (i.e. the claim cannot be restricted to preserve the personal allowance).

This claim is particularly useful where someone has given up a high-paying job to start their own business, as it may generate tax repayments at the higher or top rates of tax.

Losses made by continuing businesses

Once outside the first four tax years of trade, any loss relief against other income ("sideways loss relief") is given under s.64 ITA 2007. This relief is available against total income (before personal allowance) of the tax year:

- in which the loss-making basis period ends, and/or
- immediately preceding that year.

The loss can be used in either year first, with a separate claim made for the other year if appropriate. Neither claim may be restricted to preserve the personal allowance.

S.71 ITA 2007 and s261B and s261C TCGA 1992 allow a s.64 claim to be extended to gains of either year (once income for that year has been extinguished). In practice, this option will rarely be used, but may be useful if significant gains are made, perhaps from disposal of business assets, in the year of cessation.

After the financial crisis a decade ago, there was a temporary increase in the s.64 carry back option to three years. It will be interesting to see if Rishi Sunak does something similar over forthcoming months.

Time limit for a claim

The time limit for a claim under either s.72 or s.64 is 12 months from 31 January following the year in which the loss is made (e.g. for a 2020/21 loss, 31 January 2023).

Loss cap

Note that any sideways loss relief claim, under both s.72 and s.64, is restricted to the greater of:

- 25% of the individual's adjusted total income (i.e. total income less pension contributions) for the tax year; and
- £50,000.

Other losses to which the cap applies include qualifying loan interest and claims under s.131 ITA 2007 (capital losses on unquoted trading companies used against income). However, there is no cap on a s.131 claim where the shares qualify for EIS or Seed EIS relief.

Disclaiming capital allowances

Capital allowances increase trading losses. Clients should consider disclaiming plant and machinery capital allowances if the increased loss generated would be wasted due to the level of income being relieved.

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