The hoops to jump through

Large Corporate OMB

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Pete Miller explains why new loss restriction compliance requirements apply to all companies, not just those with profits of more than £5 million

Key Points

What is the issue?

The intention of the loss restriction that is now in CTA 2010 Part 7ZA is to restrict the loss relief available to companies with profits over £5 million so that the total loss relief is restricted to £5 million plus half the profits above that number.

What does it mean to me?

Most advisers have assumed that it is not a problem, because their clients do not have profits exceeding £5 million. However, there are compliance requirements that apply to all companies, regardless of the size of their profits or of the amounts of losses that they are trying to set off.

What can I take away?

Failure to comply with these requirements could, in some cases, mean that even small cases lose out on the ability to set off carried forward losses. The purpose of this article is to try and explain those issues.

Background

The changes to tax legislation during 2017 were probably amongst the most confusing that I can ever remember, partly because of the way the budget cycle unfolded with the unexpected general election. Readers will recall that a number of provisions that were intended to apply from 1 April 2017 were removed from the first Finance Act of that year in order to get the Act passed before the election. There was then a period of uncertainty before most of the provisions were reinstated in the second Finance Act of 2017. So we had a number of new tax provisions that were effective from 1 April 2017 but did not receive Royal Assent until 16 November 2017! Just to add to the confusion, draft amendments to the legislation were published on 6 July 2018, taking immediate effect (subject to FA 2019 getting Royal Assent, of course).

One provision that has not, perhaps, received the attention it deserves from most advisers is the loss restriction that is now in CTA 2010 Part 7ZA. The intention is to restrict the loss relief available to companies with profits over £5 million so that the total loss relief is restricted to £5 million plus half the profits above that number. For example, if a company has carried forward losses of £10 million and makes profits of £10 million in the following accounting period, the maximum set off of the carried forward losses is only £7.5 million, i.e. £5 million plus half the rest of the profits.

This DOES affect you!

The concept is straightforward but the legislation is extremely complicated. Most of us, however, have assumed that it is not a problem, because our clients do not have profits exceeding £5 million. So, like me, many of you will have assumed that this legislation has no bearing on the work that we do, and largely ignored it. Unfortunately, this would have been wrong, because there are compliance requirements that apply to all companies, regardless of the size of their profits or of the amounts of losses that they are trying to set off. Failure to comply with these requirements could, in some cases, mean that even small cases lose out on the ability to set off carried forward losses. The purpose of this article is to try and explain those issues.

Singleton companies

Let us start by looking at a stand-alone company. The company has a ‘deductions allowance’ of £5 million (CTA 2010 s 269ZW). This is the amount of profit that against which carried forward losses can be set off without

restriction. If the companies accounting period is less than 12 months, the £5 million allowance is reduced accordingly. Logically, we would assume that it means that a company with profits and carry forward losses of less than £5 million each should not suffer any kind of restriction on the set off of those losses. For example, if Pete Ltd has a trading loss in the year to 31 December 2018 of £10,000 and a trading profit of £20,000 in the year to 31 December 2019, we would expect the carried forward loss to reduce the taxable trading profit in the later year to £10,000. However, this is not the whole story!

The legislation implicitly appears to require us to divide the deductions allowance between various types of loss carried forward. Specifically, we are required to state on the company's tax return how much of the deductions allowance is to be allocated to certain types of loss.

For trading losses, part of the deduction must be allocated to carried forward losses under CTA 2010 ss 45 and 45B, as the 'trading profits deductions allowance', under CTA 2010 s 269ZB(7)(a). Section 45 losses are trading losses arising prior to 1 April 2017, which can only be set against profits arising from the same trade. Section 45B covers losses arising on or after 1 April 2017, which can also only be set against profits of the same trade, as they do not qualify for set off against total profits of the company. The legislation also states that if the trading profits deductions allowance is not stated on the return, then no such allowance is given, so that the company will not have any part of the £5 million deductions allowance allocated against these carried forward losses, so only 50% of the profits can be reduced by those losses, regardless of its profits.

To revisit the previous example, let us assume that the losses at 31 December 2018 could only be set off against profits of the same trade, under s 45B. If, in the year to 31 December 2019 Pete Ltd failed to state on the return a trading profits deductions allowance of at least £10,000 for that year, no such allowance would be given and the loss relief under s 45B would be restricted to half the profits for the year to 31 March 2019, so only £5,000 of losses could be set off, leaving £5,000 chargeable to corporation tax.

Section 269ZC contains parallel provisions for carried forward non-trading loan relationship deficits, either under CTA 2009 s 457(3) or s 463H(5), which refer to deficits that can only be used to set off against non-trading profits of the company in later years. Once again, if the amount concerned, in this case the 'non-trading profits deductions allowance' is not stated on the return, no allowance is given.

So the first big message of this article is that there is a compliance requirement in respect of certain carried forward trading losses and non-trading loan relationship deficits, to explicitly state a number on the tax return in order not to suffer a restriction in the ability to set off those losses. There is no obvious policy reason why this should be so, nor why the appropriate proportion of the £5 million allowance should be disallowed if this is not done. More to the point, at least in my opinion, is that there is no obvious policy reason why these complex compliance requirements should apply to the vast majority of companies to which this legislation otherwise simply does not apply. HMRC stated that they expected that 99% of companies to be unaffected by these rules, which turns out to be a disingenuous statement if every company with a loss relief claim is required to comply with these rules in terms of reporting requirements even if the loss restriction is not intended to apply to those companies.

The confusion is even greater when we consider that this potential loss of the ability to set off certain losses only applies to specific types of trading loss and non-trading loan relationship deficit. All the other forms of allowable loss, which can be set against total profits of a company, are dealt with under CTA 2010 s 269ZD. This has no requirement to divide the deductions allowance between the different types of loss (indeed, it appears that it does even restrict the deductions allowance by reference to amounts used under ss 269ZB and 269ZC), and there is no restriction on the use of those carried forward losses due to any failure to write them down.

CTA 2010 s 269ZZ(1) also requires a company state its deductions allowance for a period on its tax return, which seems unnecessarily repetitive, but this applies only if deductions are made to which ss 269ZB, 269ZC or 269ZD apply. Again, there does not appear to be any sanction for failure to do so.

Tax returns

The other major issue was that the online corporation tax return had not been amended to allow the figures to be stated, despite the legislation having received Royal Assent a year ago and having come into force 19 months ago. Following representations by, amongst others, the CIOT, HMRC have responded by, firstly, reminding us that the company tax return comprises not just the CT 600 return form but also the computations and the accounts (paragraph 3, schedule 18 to FA 1998). Among other things, HMRC's response to the representations refers to the guide for box 285 the CT 600, where the carried forward trading losses to be set against total profits are to be entered. There is a requirement for a detailed calculation, and HMRC say that 'inclusion of the calculation of the carried-forward losses when submitting the CT 600 will fulfil the statutory requirements' in respect of specifying amounts allocated to the trading and non-trading profits where applicable. This is, of course, very helpful, albeit somewhat belated. We are also promised further detailed guidance, later this year.

Groups of companies

Matters get even more complicated when we look at groups of companies. If a company is a member of the group, then the £5 million allowance must be split between those companies in the group that are subject to UK corporation tax. This is a logical anti-fragmentation rule and it is not surprising that there are rules also determining that one company in the group must be nominated (CTA 2010 s 269ZS) to provide a statement to HMRC as to how the £5 million is to be allocated between all of the group companies, the 'group allowance allocation statement' (ss 269ZT et seq.). A group allowance allocation statement must be submitted to HMRC by the nominated company for every accounting period (s 269ZT(1)), even if no loss set off is being claimed, as there does not seem to be any provision to say that a statement is not required if no carried forward losses are being set off in that period.

The group allowance allocation statement must give the following information (s 269ZV(3):

- identify the group to which it relates,
- specify the accounting period, of the company that is or was the nominated company, to which the statement relates ('the nominee's accounting period'),
- specify the days in the nominee's accounting period on which that company was the nominated company in relation to the group or state that that company was the nominated company throughout the period,
- state the group deductions allowance the group has for the nominee's accounting period,
- list one or more of the companies that were members of the group and within the charge to corporation tax in the nominee's accounting period ('listed companies'),
- allocate amounts of the group deductions allowance to the listed companies, and
- for each amount of group deductions allowance allocated to a listed company, specify the accounting period of the listed company for which it is allocated.

More importantly, in the context of this article, is the fact that there is no exclusion for small groups which have profits that are nowhere near the £5 million limit. There are many two-company groups, for example, with a holding company and a trading subsidiary. The holding company might be a pass-through company for dividends, or it might also hold valuable assets, such as the trading premises. Either way, assuming both companies are subject to UK corporation tax, one of those companies must be nominated to provide HMRC with a group allowance allocation statement for every accounting period! There is no exclusion for small groups,

although there does not appear to be any obvious sanction for failures in this respect, either.

HMRC's response to recent representations is to repeat the fact that 'the requirement is relevant to all groups regardless of the level of overall profits', which is simply unhelpful and unreasonable. They do, however, promise that they will be publishing a template for the group allowance allocation statement in the Company Taxation Manual, although they are having some technical difficulties at the moment. In the meantime, a document in pdf form providing the required information will be acceptable.

What are we doing about it?

In discussions HMRC have shown a total lack of commercial understanding of the time taken to comply with some of these requirements and the extra work required for firms with a large number of corporate clients, for whom the compliance burden has been increased wholly unnecessarily. In later representations, therefore, such as that by the CIOT on 5 October 2018, we have concentrated on the practical issues, such as updating the online forms, so that the statutorily required numbers can be inserted, and updating and clarifying the guidance, to make it clear what is required by companies to ensure that their ability to use losses is not restricted unnecessarily and contrary to the policy intention.

HMRC's response does provide some helpful information about how companies should satisfy the compliance requirements, although some of them feel (to me, at least), as though they have an element of fudging. I hope the response will be widely publicised. But while it is helpful to know how to comply, none of this addresses the fundamental issue of why some of these requirements are there in the first place. And there are a lot of people out there that have no idea of the new compliance burdens, because they have assumed that they or their clients are within the unaffected 99%!