Think Ahead ACCA

Technical factsheet

Corporation tax trading losses: group relief

Part 5 of Corporation Tax Act 2010 (CTA 2010) allows a company to surrender losses and other amounts, and enables, in certain cases involving groups or consortiums of companies, to claim corporation tax relief for the losses and other amounts that are surrendered.

Group relief is a relief from corporation tax. The basic idea is to tax the economic unit that gives rise to profits over a corresponding period.

If a company makes profit of £200 and that company has a subsidiary that is making a loss of £100, in economic terms there is just one unit (the group) that makes a profit of £100, so the group pays tax on the overall profit it makes.

While group relief allows the transfer of losses between companies, it does not treat a group of companies as if it were a single company for tax purposes. The companies are still treated as separate legal entities for tax: for example, the surrendering company must actively consent to the claimant company utilising its losses.

Claims may be made:

a) for trading losses and other amounts eligible for corporation tax relief (see below) where both the claimant and surrendering companies are within the charge to corporation tax or

b) for losses and other amounts not eligible for corporation tax relief (effectively for 'qualifying overseas losses') arising to an 'EEA company'.

An 'EEA company' is a non-resident company within the charge to tax under the law of any European Economic Area (EEA) territory, and which is either resident in any EEA territory or not so resident but carrying on a trade through a permanent establishment in any EEA territory.

What losses and other amounts can be surrendered as group relief?

The in-year group relief rules are contained in Part 5 of CTA 2010 while the carry-forward group relief rules are contained in part 5A of CTA 2010. Under both sets of rules, there is a concept of an ‘overlapping period’ for which losses can be surrendered, as follows:

Subject to various restrictions, limits and order of relief, a claim for group relief is possible where the ‘surrendering company’ consents to the claim, and the claimant company and the surrendering company are in the same (75%) group for an ‘overlapping period’. An overlapping period is a period of at least one day in common between ‘the claim period’ and ‘the surrender period’.

The claim period is the accounting period of the claimant company for which it claims group relief. The surrender period is the accounting period of the surrendering company to which the losses and other amounts have been carried forward to. The surrendering company means the company that has the losses or other amounts.

The following can be surrendered as group relief by a company for an accounting period:

a) **Trading losses** except losses from trades carried on wholly overseas; or from trades not carried on on a commercial basis and with a view to the realisation of profits.
b) **Capital allowances excess** refers to the excess allowances that have been deducted from or set against income from special leasing of plant and machinery. Such excess allowances may be surrendered in so far as they exceed such income for an accounting period (before deduction of losses or capital allowances brought forward) and the plant or machinery is not used by the lessee for a non-qualifying purpose.
c) **Non-trading deficit on loan relationship** – the surrendering company does not have to use the deficit against its other income in priority to surrendering some or all of it as group relief to a fellow group member, nor is the amount that can be surrendered restricted to the excess over other profits for the accounting period of surrender.
d) Amounts allowable as **qualifying charitable donations**. A qualifying charitable donation is a ‘relevant amount’ for the group relief provisions, so can only be surrendered to the extent that the total of the surrendering company’s relevant amounts exceeds the ‘profit-related threshold’ (or ‘gross profit’ in surrendering periods ended before 20 March 2013). This is the case regardless of whether the surrendering company uses any of the relevant amounts against its own profits. The calculation will need to take into account the prescribed order of surrender of relevant amounts.
e) **UK property business loss** excluding losses brought forward from earlier periods and losses incurred in a property business that was not carried on either on a commercial basis or in the exercise of statutory functions. However, property business losses arising after 1 April 2017 that are carried forward may be relieved as group relief for carried forward losses (CTA10/Part 5A). A loss from a UK property is a ‘relevant amount’ for the

group relief provisions, so business can only be surrendered to the extent that the total of the surrendering company's relevant amounts exceeds the 'profit-related threshold' (or 'gross profit' in surrendering periods ended before 20 March 2013).This is the case regardless of whether the surrendering company uses any of the relevant amounts against its own profits. The calculation will need to take into account the prescribed order of surrender of relevant amounts.

f) **Management expenses** of companies with investment business. This does not apply where the surrendering company carries on the business of life assurance. Excess management expenses does not include: management expenses brought forward from another accounting period, or brought forward losses of a company with investment business, that ceases to carry on UK property business, that are treated as management expenses of the current period.
Management expenses is a 'relevant amount' for the group relief provisions, so can only be surrendered to the extent that the total of the surrendering company's relevant amounts exceeds the 'profit-related threshold' (or 'gross profit' in surrendering periods ended before 20 March 2013). This is the case regardless of whether the surrendering company uses any of the relevant amounts against its own profits. The calculation will need to take into account the prescribed order of surrender of relevant amounts.

g) **Non-trading loss on intangible fixed assets (NTLIFA)** – the amount surrendered must exclude sums carried forward from previous periods. However, where NTLIFAs arise in periods beginning on or after 1 April 2017, group relief can be claimed for carried forward losses. The claim is restricted for any part of the loss that is made up of an amount brought forward from an accounting period beginning before 1 April 2017. A surrendering company cannot surrender a carried forward NTLIFA if the investment business became small or negligible before the beginning of the period.
Non-trading losses on intangible fixed assets is a 'relevant amount' for the group relief provisions, so can only be surrendered to the extent that the total of the surrendering company's relevant amounts exceeds the 'profit-related threshold' (or 'gross profit' in surrendering periods ended before 20 March 2013). This is the case regardless of whether the surrendering company uses any of the relevant amounts against its own profits.

The calculation will need to take into account the prescribed order of surrender of relevant amounts.

In conclusion: trading losses, excess capital allowances and non-trading deficits on loan relationships (a to c above) may be surrendered in full. This is regardless of whether the surrendering company has other profits against which the losses and other amounts might have been set off.

Qualifying charitable donations, UK property business losses, management expenses and non-trading losses on intangible fixed assets (d to g above) may only be surrendered to the extent that they, in aggregate, exceed the 'profit-related threshold' (or 'gross profit' for surrender periods ended before 20 March 2013). The

calculation will need to take into account the prescribed order of surrender of relevant amounts as per legislation.

The order of 'set off for surrender purposes' is taken to consist of

a) first, charitable donations
b) second, UK property business losses
c) third, management expenses and
d) fourth, non-trading losses on intangible assets

The '*profit-related threshold*' is the sum of the surrendering company's 'gross profits'. Where the company is a chargeable company for controlled foreign company (CFC) purposes, the amount of any CFC chargeable profits apportioned to the company.

The company's '*gross profits*' are its profits without any deduction in respect of amounts within a-g above or of any losses, allowances or other amounts of other periods. This does not include capital losses brought forward from a previous period and deducted as part of the computation of chargeable gains.

A company within the group must give a notice of consent to surrender those losses to the claimant company. The claimant company must make a claim for relief in its tax return for the affected period.

The claim must be made in the return for the accounting period of relief or by an amendment to that return. The notice of consent must be given at or before the time of the claim.

The availability of group relief as above is subject to restriction in the case of dual resident investing companies, certain ring-fenced activities, certain transactions in relation to the sale of lessor companies and certain transactions by leasing partnerships.

There are special rules that apply:

- to UK permanent establishments of companies resident outside the UK and overseas permanent establishments of UK resident companies, if there is the possibility of relief being given in a jurisdiction other than the UK
- if there are arrangements that could affect the group relationship
- if the loss arises to a 75% subsidiary resident in a European Economic Area (EEA) territory.

Losses of EEA group members

For accounting periods ending or treated as ending before 1 April 2006, a UK parent (or a UK resident subsidiary of the UK resident parent company) with a foreign subsidiary that has incurred a foreign loss and either

- is resident in the EEA or
- incurred the loss in a permanent establishment in the EEA

may in principle (in accordance with the ruling of the European Court of Justice (ECJ) in Marks & Spencer v Halsey) claim to set an amount representing the foreign tax loss against its profits.

The claimant should demonstrate that:

- the foreign subsidiary *has exhausted the possibilities available in its state* of residence of having the losses taken into account for the accounting period concerned by the claim for relief and also for previous accounting periods, if necessary by transferring those losses to a third party or by offsetting the losses against the profits made by the subsidiary in previous periods, and
- there *is no possibility* for the foreign subsidiary's losses to be taken into account in its state of residence *for future periods* either by the subsidiary itself or by a third party, in particular where the subsidiary has been sold to that third party.

The onus remains on the claimant to demonstrate that it meets the tests imposed by the ECJ in its ruling. The interpretation and application of the preliminary ruling of the ECJ in Marks & Spencer plc v Halsey remains the subject of continuing litigation before the special commissioners and may possibly give rise to further appeals on a point of law.

Accounting for current year and prior year relief for trading losses

Generally, if a company incurs a trading loss in any accounting period it may claim to first offset that loss against its total corporation tax profits for the same accounting period.

The claim may also require that any unrelieved balance of the loss be carried back against total profits of the previous accounting period or periods, so far as they fall (wholly or partly) within the period of 12 months ending with the start of the loss-making period.

The legislative reference for a current year claim is **CTA 2010 s37(1)(2)(3)(a)**.

Restrictions on the use of losses can apply to companies with losses in excess of £5m from 1 April 2017.

Making an early claim

Due to the impact that Covid-19 has had on businesses, HMRC has now acknowledged that, in exceptional circumstances, claims for repayments of corporation tax for prior periods based on anticipated losses before the current accounting period has concluded will be considered.

As a result HMRC has updated its corporation tax **guidance**, covering situations where a company seeks repayment of tax **before a return has been filed**.

Where a company knows that it has suffered large losses, it can seek relief for those losses against profits made in a previous profit-making period and reclaim the associated corporation tax that was paid over to HMRC.

The company must give notice to HMRC stating the amount that it considers should be repaid, together with the change of circumstances and grounds for believing that the amount paid exceeds the company's probable liability to corporation tax.

The most common example of this will be a company that:

- has paid tax for accounting period 1 (AP1)
- during accounting period 2 (AP2) believes it will make a loss that it intends to carry back to AP1.

Until AP2 has ended, no allowable loss has crystallised and the company cannot anticipate losses/reliefs and obtain repayment. The reason for this is because loss relief claims under CTA10/S37 require that AP2 losses are first set against profits of that accounting period before the remainder can be carried back.

Until AP2 has ended, the full extent of the profits and losses of that accounting period also cannot be determined with any degree of certainty. This means that in practice it is very difficult to establish that a specified amount will be available for carry back and to produce an accurate revised calculation of liability.

After the end of AP2, however, HMRC may accept draft accounts or management accounts as evidence that the company has grounds for believing that it has paid too much tax.

Providing an acceptable form of evidence is therefore critical to the timely success of a repayment. Any submission to HMRC requesting the early carry back of losses will need sufficient evidence that losses will be included in the company tax return for the loss-making period when it is eventually submitted.

Terminal loss relief

Two types of terminal loss relief are available to corporates:

1. *Terminal relief for losses in the final 12 months of trade*

   This relief allows a company to carry back any trading losses that occur in the final 12 months of a trade and set them off against profits made in any or all of the three years up to the period of the loss. As normal, losses can only be set off if the company was carrying on the same trade and they are claimed on a last-in, first-out basis.

   On a practical note, terminal loss relief has to be claimed. A claim must be made within two years of the end of the accounting period in which the loss was made. The claim is normally made within the tax return or an amended tax return.

2. *Terminal relief for carried forward losses of a trade from 1 April 2017*

From 1 April 2017, if a company stops trading, it may be able to claim terminal loss relief for *carried forward losses* of that trade.

This is designed to give additional relief to companies that have been prevented from fully relieving profits of the final three years of a trade, due to restrictions on relief for carried forward losses.

Losses that can be used are trade losses carried forward to the final accounting period when the trade ceased. These losses can be used to reduce profits:

- of the final accounting period
- for earlier periods up to three years before the end of the final accounting period.

You can only use this relief to reduce profits of the three years ending with the end of the period in which trading stopped. This is not the same as the three-year period that applies for losses that occur in the final 12 months of the trade.

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