HM Treasury

HM Revenue & Customs

Reforms to corporation tax loss relief:

response to the consultation

December 2016

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Executive summary

At Budget 2016 the government announced reforms to the UK loss relief regime to make the system more flexible for business, whilst ensuring businesses making substantial annual profits pay tax. From 26 May 2016 to 18 August 2016 the government ran a consultation on the reforms and received 79 responses.

Reflecting constructive stakeholder engagement with the consultation, the government is taking a number of steps in order to address unintended consequences of the reforms and simplify its administration.

Draft legislation for the core rules can be found alongside this response to the consultation. The government intends to publish the remaining draft legislation for consultation by the end of January 2017.

Simplification

There were concerns that the reforms to loss relief set out in the consultation document would add complexity to the system. The government has taken steps to address this:

- companies will be able to set post-April 2017 carried-forward losses against total profits, instead of first setting these against relevant trading profits or relevant non-trading profits
- companies will be able to apply in-year reliefs for the purpose of the loss restriction calculation across income streams at their discretion, as opposed to apportioning them between trading and non-trading profits
- companies with neither pre-April 2017 trading losses nor pre-April 2017 non-trading loan relationship deficits can perform a simpler loss relief calculation
- the definition of a group for the allocation of the £5 million allowance will be based on the definitions used for the purposes of group relief rather than on the IFRS 10 definition

Unintended consequences

Responses to the consultation highlighted some of the unintended consequences of the reforms, which the government has taken steps to address:

- when a company ceases trading, it will be entitled to use remaining carried-forward trading losses against the profits of the final 36 months without restriction
- the government will no longer look to expire all of a company's losses when it has gone into liquidation

Anti-avoidance

Whilst there are anti-avoidance provisions currently in place for loss relief, the increased flexibility in how companies use losses brings new opportunities for avoidance behaviour. The government will therefore introduce anti-avoidance legislation to protect the tax system from these additional risks, which include provisions to protect against:

- groups acquiring companies to use their carried-forward losses (loss buying)
- losses being set against total profits or surrendered to group companies where the trade or activity that generated them has ceased or become small or negligible
- carried-forward losses being refreshed, so they can be used more flexibly (by extending the existing anti-loss refresh rules to include property losses and non-trading losses on intangible fixed assets)
- arrangements with the main purpose of obtaining a benefit under the loss relief reform rules, for instance manipulation of the group structure to maximise the amount of annual allowance due or artificial inflation of profits to increase the losses that can be used under the loss restriction rules

Policy interactions

The government has also provided clarification on a number of policy interactions between the reforms and other areas of the tax system, including on double taxation relief and the application of the reforms to consortia.

As also set out in the consultation document, ring fence Oil and Gas activity and excess Basic Life Assurance and General Annuity Business expenses will be exempt from the reforms. The government has set out more detail on how these exemptions will apply. The government has also extended exemptions to Real Estate Investment Trusts, UK furnished holiday lettings and losses within the creative industry regime.

1 Introduction

Proposed policy

1.1 At Budget 2016 the government announced reforms to the UK loss relief regime such that it would make the system more flexible for businesses, whilst ensuring businesses making substantial profits pay tax.

1.2 To achieve this, losses arising from 1 April 2017 when carried forward will be given more flexibility and will be able to be set against the total taxable profits of a company and its group members. Additionally, the amount of profit that can be relieved by carried-forward losses will be restricted to 50 percent, subject to an allowance of £5 million per stand-alone company or group.

1.3 These reforms bring the UK loss relief regime more in line with other G7 economies, and the £5 million allowance ensures that 99% of companies are unaffected by the restriction.

Consultation and government response

1.4 In May 2016, the government published a consultation on the reforms, setting out its objectives, detailing the proposals for reform, and welcoming feedback on the technical details of its implementation. The government has received 79 responses on this consultation and the government is grateful for the time taken by all of those who contributed.

1.5 This document provides a summary of the issues raised in the consultation and sets out the government's response. To reflect the constructive engagement with the consultation, the government is taking a number of steps in order to address unintended consequences of the reforms and simplify its administration.

1.6 Draft legislation for the core rules can be found alongside this response to the consultation. The government intends to publish the remaining draft legislation for consultation by the end of January 2017. Further information on the publication timing of each component of the draft legislation can be found at Annex C.

Overall comments

1.7 Respondents raised concerns about the potential impact of the restriction on UK competitiveness. Some questioned the timing of the policy and whether, in light of the EU referendum outcome, the government should press ahead with the reforms from 1 April 2017. Some also noted the treatment of pre-2017 losses, arguing that they should either be free from the restriction or that the increased flexibility should apply to pre-2017 losses as well.

Government response:

1.8 The government remains committed to a competitive tax system and notes the views of business on the appropriateness of this measure.

1.9 The government is, however, committed to implementing these reforms to the loss relief regime on 1 April 2017. The reforms are an affordable means of modernising the tax system, that ensure businesses have more flexibility in how they utilise loss relief whilst ensuring those making substantial annual profits pay tax.

1.10 The government will take steps to address unintended consequences of the reforms and simplify the measure.

1.11 It will not, however, revise the fundamental features of the reforms announced at Budget 2016. These include the date of implementation, the 50% level of restriction, the quantum of the £5 million allowance, and the treatment of pre-April 2017, post-April 2017 and capital losses.

2 Simplification

Loss relief calculation

2.1 Respondents commented on the additional complexity of the proposed loss relief calculation. Elements of the measure that were deemed to add to the complexity were the requirement to use pre-April 2017 losses before post-April 2017 losses; the continuing requirement to set pre-April 2017 and post-April 2017 losses against particular types of income; the proportionate apportioning of in-year reliefs against trading and non-trading profits for the purpose of computing the restriction; and the requirement to set post-April 2017 losses against relevant trading profits and relevant non-trading profits before total profits.

2.2 Other suggestions proposed allowing losses to be used against total profits with the exception of chargeable gains and simplified calculations for groups with losses or profits below £5 million, or for groups with no pre-April 2017 losses.

2.3 A few respondents also sought clarity on how the new calculation would interact with the automatic offset of carried-forward losses; the existing deferral of non-trade loan relationship deficits; and where a company's accounting period straddles 1 April 2017 or where companies surrender to others with differing accounting periods.

2.4 Some respondents also expressed concern over proposals to stream post-April 2017 property losses.

Government response:

2.5 The government recognises that additional tax complexity can sometimes be the undesirable side effect of ensuring a fair tax regime that is robust to risks of avoidance and abuse. However, the government is committed to doing what it can to deliver a simple tax regime so that businesses understand their tax liabilities and can interact easily with the system. The government has taken steps to simplify the loss restriction calculation.

2.6 The government will not legislate for the proportionate apportionment of in-year reliefs as was proposed in the consultation document. Companies will instead have total flexibility in how in-year reliefs are set against trading and non-trading profits for the purpose of computing the loss restriction. The government will also allow all post-April 2017 losses to be used against total profits, rather than first against relevant trading and non-trading profits. This will include trade losses, non-trading loan relationship deficits and UK property business losses.

2.7 Maintaining the distinction between pre-April 2017 and post-April 2017 losses is fundamental to ensuring the reforms are an affordable means of modernising the loss relief regime. The separate treatments for pre-April 2017 and post-April 2017 losses will therefore continue. However, the government will remove the requirement to use pre-April 2017 losses before post-April 2017 losses, allowing businesses more flexibility in how these are used. Furthermore, companies will be allowed to make a claim, the effect of which is that pre-April 2017 carried-forward trading losses will be allowed not to be set against profits of the same trade in the next accounting period, but instead carried forward to a later period. This will provide companies with the flexibility to choose whether or not to use pre-April 2017 losses before other available losses. A similar provision exists currently for non-trading loan relationship deficits and this will be retained.

2.8 Where an accounting period straddles 1 April 2017, losses and profits for that accounting period will be split between pre-2017 and post-2017 losses and profits on a time apportioned basis. For example, if a company incurs £1 million in losses and £1 million of profits in an accounting period commencing 1 January 2017, £246,575 (January, February, and March; 90 days out of 365) would be pre-April 2017 losses, and £753,425 would be post-April 2017 losses. The profits would be apportioned in an identical fashion. Where time-apportioning the profits and losses does not give a just and reasonable answer, another just and reasonable approach may be used.

2.9 The government will legislate for a simplified calculation for companies who do not have or elect not to use pre-2017 trading losses or pre-2017 non-trading loan relationship deficits (NTLRDs). Where a company uses neither pre-April 2017 trading losses nor pre-April 2017 NTLRDs, the requirement to first apportion profits between trading and non-trading profits will be removed. The revised loss relief calculations can be found at Annex A.

2.10 The government will not, however, legislate for simplified calculations for groups with less than £5 million of losses or profits. This is because companies will not be able to assess whether their relevant profits fall below the £5 million threshold without preparing the calculation, and where the company is a member of a group, the test would need to be applied across all group members to determine whether the £5 million threshold has been exceeded at group level.

2.11 The government asked in the consultation whether property losses should be set first against property income in the same way as trading losses were to continue to be set first against trading profits for post-April 2017 losses. Given that respondents were not keen on such a set-off for property losses, and that trading losses will no longer be set first against trading profits, the government will not legislate to set property losses first against property income. Property losses will continue to be set against total profits.

2.12 As set out in the consultation, the government will not make changes to the schedular system as part of these reforms. The government has asked the Office of Tax Simplification (OTS) to examine the schedular system as part of their review of the corporation tax computation[1], and will consider the OTS's final recommendations in due course.

Group definitions

Allocation of the £5 million allowance

2.13 Over half the respondents commented on how the £5 million allowance is allocated within a group of companies. They broadly expressed concern that the IFRS 10 definition, proposed in the consultation document, would add complexity. It was instead widely proposed that a definition based on the conditions for allowing group relief was used, with some suggesting accompanying anti-avoidance provisions to prevent abuse. Some respondents acknowledged that the group relief definition for allocating the £5 million allowance posed risks and suggested definitions based on "control" or "associated companies" as defined in the Taxes Acts, or the definitions used for Annual Investment Allowances or the Tax deductibility of corporate interest expense legislation that has effect from 1 April 2017. Other concerns raised were that the allowance would need to ensure companies in insolvency proceedings, owned by investment funds or which are minority interest shareholders were not disadvantaged when the allowance is allocated.

[1] The Progress report can be found at https://www.gov.uk/government/consultations/ots-review-of-the-corporation-tax-computation-consultation

2.14 Additionally a few respondents also expressed concern over the features of the £5 million allowance. Some highlighted that the government should look to regularly review the size of the allowance. Others sought clarification on how the allowance would be allocated when there are mid-year changes in accounting periods, when there are shortened accounting periods or when companies in the same group have differing accounting periods.

Government response:

2.15 The government feels the group relief definition in isolation is unsuitable for allocating the £5 million allowance. This definition is easy to break, by design, and would present a risk of abuse that groups could fragment in order to increase the number of allowances for which its group members would be eligible. However, the government recognises the broad consensus of the benefits of using a definition that is aligned with how carried-forward losses are surrendered to group companies to avoid additional complexity. The government will therefore use the group relief definition as a basis for the new definition. The new definition will include additional criteria to ensure companies cannot easily break the group relationship for the purposes of gaining their own £5 million allowance.

2.16 The government has acknowledged the concerns that minority interest shareholders, companies in insolvency proceedings or those owned by an investment fund may be negatively impacted by the discretionary allocation of the allowance. The government, however, believes that any stipulations in how this allowance is allocated would run contrary to the government's objective for allowing more flexibility in the UK loss relief regime. The government will legislate therefore for a fixed £5 million annual allowance, to be allocated at a group's discretion.

2.17 The government also sets out its response to the issues raised around companies in insolvency proceedings in the 'Distressed companies' section.

Surrender of carried-forward losses

2.18 Many respondents commented on the group definition proposed for the surrender of carried-forward losses. Respondents unanimously agree that the current group relief definition should be used.

Government response:

2.19 As proposed in the consultation document, the government will legislate for the existing group relief definition to be used for the surrender of carried-forward losses to other group companies.

3 Unintended consequences

Fixed-term investment projects

3.1 Respondents noted that loss restriction could have a significant impact on fixed-term investment projects, which can make large upfront losses that are recouped by profits near the end of the project. They noted the loss relief reforms may mean projects pay tax earlier than projected, and may not be able to relieve all the losses incurred against profits before the cessation of the fixed-term project. Suggestions to mitigate these outcomes included increasing the flexibility of capital allowances at the end of a project; to exempt losses generated from capital expenditure from the restriction; exempting investment-intensive projects from the restriction; grandfathering existing infrastructure projects; or capping the amount of losses that could be restricted in one accounting period.

Government response:

3.2 The government recognises the impact that the loss restriction may have on fixed-term investment projects. It is not the intention of the loss restriction to change the availability of relief for carried-forward losses, but instead the timing of the relief. The government will therefore legislate for increased flexibility to address this unintended consequence.

3.3 When a company ceases trading, it will be entitled to use any remaining carried-forward trade losses against profits arising in the final 36 months of the trade without restriction ('terminal carried-forward loss relief'). For post-April 2017 losses, these will be able to be set against total profits, whilst pre-2017 losses trading losses will only be able to be set against profits of the same trade. The profits that losses can be carried back to will be limited to those generated from 1 April 2017, since before this date there would have been no restriction on the amount of profit against which losses could be set. The use of losses without being subject to the restriction will only be available to the company whose trade has ceased and not group companies.

3.4 Under current law, when a company ceases trading it is entitled to carry back any in-year trading losses incurred in its final accounting period of activity against its previous three years' profits ('terminal loss relief'). These provisions remain unchanged.

New entrants

3.5 Respondents commented on the impact the restriction would have on start-up companies and companies making initial investments into the UK, with many believing the restriction would damage the UK's attractiveness and the success of new entrant companies. A common suggestion to mitigate this was to remove the restriction for the first 3 to 5 years of business activity in the UK. Other proposals included allowing 100% final year relief for losses incurred over the project or replicating the Public Benefit Project Exclusion (PBPE) used in the limitation of corporate interest expense deductibility.

Government response:

3.6 The government believes the availability of the £5 million annual allowance of unrestricted profit will ensure most start-ups and new entrants will not pay tax until they are making substantial annual profits. As discussed in the 'Fixed-term investment projects' section, in the case of a cessation of trade, the government will allow companies to use carried-forward trade losses against profits of the final 36 months without restriction.

3.7 Allowing 100% relief for losses incurred in the early years of a company would require additional tracking of losses, as well as a robust definition for a new entrant to ensure against abuse. The government will therefore not legislate for an exemption for new entrants, due to the availability of the £5 million allowance and to avoid the additional complexity associated with such a change.

Distressed companies

3.8 Some respondents noted the impact the restriction may have on companies in distress. For example, those in insolvency or liquidation can face volatile profits between years when undergoing financial restructuring. Respondents mentioned that the loss restriction could push companies into tax payments that would have otherwise likely been fully covered by carried-forward loses, or that changes would hinder the prevention of insolvency. Suggestions to mitigate this included extending the current 'corporate rescue exemption' rules in Part 5 of CTA 2009 or carving out companies in distress from the restriction altogether.

Government response:

3.9 The government recognises these concerns and is committed to ensuring companies in distress are not unduly impacted by the new rules.

3.10 The £5 million allowance will remove the overwhelming majority of companies in distress from the loss restriction. As discussed in the 'Fixed-term investment projects' section, the government will allow companies to use the stock of carried-forward losses against the previous 36 months' profits upon cessation of trade without restriction. This will help ensure the loss restriction impacts the timing but not the availability of the losses.

4 Anti-avoidance

4.1 Respondents commented on the anti-avoidance provisions, and many believed that existing anti-avoidance rules offered sufficient protection. Others believed that the introduction of any new rules should be targeted, not general, avoid complexity and avoid impacting genuine economic activity. Some respondents proposed reviewing the case for new anti-avoidance legislation once the measure was in place and that extending the rules could include using the Disclosure of Tax Avoidance Schemes (DOTAS) arrangements or a simple motive test.

4.2 Many respondents commented specifically on the loss buying and trade cessation proposals set out in the consultation document. Some respondents agreed that protections would be needed, such as limiting the flexibility available to pre-acquisition losses on change of ownership where there is a major change in the nature or conduct of a trade. A few respondents felt current rules would be sufficient, or that any new rules should only apply to pre-April 2017 losses.

4.3 Others felt that the rules for loss buying and trade cessation should be more flexible, or questioned the rationale for extinguishing losses when a business ceases. Proposals included allowing losses to be used against the acquired company's profit, allowing acquired losses to be used against wider group profits or that when the business ceases the company's losses should be transferred to other group companies so the group can still access the losses.

Government response:

4.4 The increased flexibility in how companies use losses brings new opportunities for avoidance behaviour. The government will therefore introduce or extend existing anti-avoidance legislation to protect the tax system from these additional risks.

Acquisitions

4.5 The risks around loss buying are currently limited, because some pre-2017 carried-forward losses cannot be set against total profits and none of them can be surrendered to group members. However, the reforms will allow greater flexibility, and therefore the risks of abuse will grow as post-April 2017 losses are accrued. The government will therefore introduce rules that specify that where a loss-making company is acquired:

- on a change of ownership, pre-acquisition carried-forward losses cannot be surrendered into the new group for a period of 5 years
- the existing loss buying rules will continue to apply so if there is a change of ownership and one of the loss buying conditions are met (e.g. a major change in the conduct or nature of a trade or investment business), any pre-acquisition losses of the relevant trade or investment business will be forfeit. The time limit for considering whether the loss buying conditions have been met will be extended to 5 years after the change of ownership
- if there is a change of ownership and in the subsequent 5 years there is a change in the nature or conduct of any trade or business against which post-April 2017 carried-forward losses could otherwise be set, pre-acquisition carried-forward losses will not be allowed against profits of the trade or business the nature of which has changed

Cessation

4.6 Under current legislation, if a trade, property business or investment business ceases, then the associated trade losses, property losses or management expenses expire. Because of the increased flexibility in the use of losses, there is a risk that a trade or investment business may be continued artificially to makes use of losses where the trade or investment business becomes small or negligible. The government will therefore introduce legislation so that where a trade, property business or investment business becomes small or negligible:

- trade losses will be available only to carry forward and set against profits of the same trade
- property losses will be available only to carry forward and set against profits of the same company
- management expenses will be available only to carry forward and set against profits of the same company

4.7 Currently there is no corresponding rule that expires NTLRDs and non-trading losses on intangible fixed assets (NTLIFAs) on cessation. The government will therefore introduce legislation so that NTLRDs and NTLIFAs will expire where the related investment business ceases. Where the investment business becomes small and negligible:

- NTLIFAs will be available only to carry forward and set against profits of the same company
- NTLRDs will be available only to carry forward and set against non-trading profits of the same company

4.8 The government set out in the consultation document that it intended to include a provision within the legislation which would mean that companies' carried-forward losses would expire when there is no possibility of them being used going forward, for example on liquidation. Following consultation the government realises that the provision would have undesirable consequences, for example, where companies in liquidation make taxable profits. The government will instead legislate so that when a company disposes of all assets that have a possibility of producing income, it can no longer surrender its carried-forward losses to other companies within the group.

Transfer of deductions

4.9 The government also intends to extend the "transfer of deductions" rules in Part 14A CTA 2010 so that these apply to carried-forward losses. These rules currently apply where a company with a latent loss is acquired (for example, where expenditure incurred is deferred until later periods under normal commercial principles) and prevent that loss, when realised, from being set against the company's total profits or surrendered as group relief. Legislation will be introduced that will prevent carried-forward losses from being set against a company's total profits or surrendered as group relief where the conditions for applying the existing legislation are met.

Loss refresh

4.10 As set out in the consultation document, the government will extend the existing anti-loss refresh rules. These prevent groups from entering into arrangements that turn their carried-forward losses into in-year losses. The rules currently only apply to trading losses, NTLRDs and management expenses, and will be extended to UK property losses and NTLIFAs.

Targeted Anti-Avoidance Rule

4.11 The final change will be to introduce a loss relief reform Targeted Anti-Avoidance Rule. This will target particular types of arrangement that seek to exploit the rules, such as manipulation of the group structure to maximise the amount of the annual allowance due or artificial inflation of profits to increase the losses that can be used under the loss restriction rules.

4.12 The government is aware that the increased flexibility of post-April 2017 losses increases the risk of avoidance and so the government will monitor this risk and take action to combat any attempts to frustrate the aims of the policy.

5 Policy interactions

Insurers

General comments

5.1 The insurance sector expressed concerns that due to the volatility of profits in the sector, the restriction will have a disproportionate effect on them. To mitigate this impact, respondents proposed: averaging profits over more than one accounting period; moving from a fair market valuation of assets to a realisation basis for tax; or to ease the level of restriction. Insurers also expressed concerns about the future interactions between the reforms and IFRS 4 Phase II, an accounting change which is still under development.

5.2 Some respondents welcomed that existing loss carry-back rules would remain unrestricted, saying it would help insurers address short term fluctuations in profits.

Government response:

5.3 The government recognises the importance of the insurance sector to the economy and the social value that its services provide. However, diluting the impact of the loss restriction for certain sectors because they experience more volatile profits and losses would contradict the fundamental policy of the loss restriction. The government is committed to implementing the loss relief reforms from April 2017.

Regulatory capital requirements

5.4 As recognised in the consultation document, insurers raised that the loss restriction could both reduce the balance sheet value of existing losses, and reduce the value that insurers can obtain for losses in calculating their solvency capital requirement in a '1 in 200' stress event. This was a particular concern for insurers who are currently getting regulatory capital recognition for those '1 in 200' losses, and these insurers suggested turning off the restriction when a '1 in 200' stress event occurs.

Government response:

5.5 The government understands the significance of carried-forward losses for insurers subject to the regulatory capital requirements for Solvency II. It understands that the 50% restriction could require an insurer to reduce the value of carried-forward losses recognised on its balance sheet as a deferred tax asset, which could in turn potentially reduce its loss absorbing capital and thus reduce its capital ratio.

5.6 The government has consulted extensively with the insurance sector, the Association of British Insurers (ABI) and the Prudential Regulation Authority (PRA) on this issue. It was confirmed that the value of deferred tax assets may be reduced as a result of these changes to the extent that the use of losses is restricted. The government believes that a reduction in the balance sheet value of existing losses is an acceptable consequential impact of the new rules.

5.7 The government also understands that the 50% restriction could similarly reduce the value assigned to tax losses incurred by insurers in a '1 in 200' stress event, which could potentially increase the insurer's Solvency Capital Requirement and thus reduce its capital ratio.

5.8 It is not the government's intention for the restriction to reduce the value that insurers can obtain for losses incurred in a '1 in 200' stress event. The government does not, however, consider that there are options to address this impact that are practical, legal, and justifiable from a policy perspective. Given that the impact on insurers' capital ratios is anticipated to be manageable, and not give rise to prudential concerns, the government has decided against taking action here. The government will, however, continue to monitor closely any regulatory consequences of the loss relief reforms.

Life insurers

5.9 Respondents agreed with the proposal set out in the consultation document that the policyholder share of Basic Life Assurance and General Annuity Business (BLAGAB) should be out of scope of the loss relief reforms. Respondents took a mixed view as to whether the loss relief reforms should be applied to the shareholders' share of the 'I minus E' profit. Some suggested extending the exemption to all 'I minus E' profits, and others were content for the loss restriction to apply to carried-forward BLAGAB trade losses and welcomed the increased flexibility that the loss relief reforms brought.

5.10 Some respondents noted the interaction between the loss relief reforms and the Finance Act 2012 Schedule 17 – notably where the tax charge associated with a spike in profits originating from the accounting change in 2012 would be spread evenly over the following 10 years – could present an opportunity to soften the impact of the loss restriction. Some also mentioned that the ordering of offset for BLAGAB losses would need amending, as group relief is currently claimed before carried-forward losses.

Government response:

5.11 The government will legislate to ensure that the policyholders' share of the 'I minus E' profit is outside of the scope of the loss relief reforms so that policyholders are not unfairly impacted by the measure.

5.12 The government does not propose to make any changes to the basis of calculation of the 'I minus E' profit and in particular the loss restriction rules will not apply to any items that are treated as a 'BLAGAB management expense' of the period, a 'deemed management expense' of the period or as a 'BLAGAB management expense' of the following period.

5.13 Once the above considerations are taken into account there is, from a policy perspective, no clear case for excluding life insurance companies from the loss relief reform measure. Accordingly, the government will introduce legislation to ensure that the loss relief reforms will apply to carried-forward BLAGAB trade losses and to the shareholders' share of the 'I minus E' profit.

5.14 Transitional items arising under Schedule 17 are treated as items of income or expense in calculating BLAGAB trade profits or non-BLAGAB trading profits. The government does not see any requirement for special rules to apply in respect of these transitional items.

Banks

5.15 Many respondents cited the additional compliance banks would face under the three sets of loss relief rules (the two rules for pre-April 2017 and post-April 2017 losses and the existing rules for pre-April 2015 losses) and proposed simpler calculations such as including all losses under the 50% restriction, not stipulating order of use on each type of loss and allowing the £5 million allowance to be deducted after the carry-forward of bank loss restriction losses, but before the carry-forward of other losses.

5.16 Some respondents also raised concerns over whether the tightening of the bank loss restriction was necessary and whether the bank loss restriction could be phased into the economy-wide regime. Others also expressed concern over the interaction between the loss relief calculation and the bank surcharge calculation, suggesting that losses surrendered from other companies within the group should be taken into consideration before applying the surcharge.

Government response:

5.17 Many of the losses subject to the bank loss restriction are related to the financial crisis. The government believes it is important to maintain the distinction between these losses and economy-wide losses, and will therefore continue to subject pre-2015 banking losses to the 25% restriction.

5.18 The government is keen to align the bank loss restriction and general loss restriction calculations as far as possible in order to minimise the administrative burden to banking companies of complying with two sets of loss restriction rules, and matching the calculations of 'relevant profits' for the two measures helps to achieve this. The £5 million allowance is a mechanism for calculating the amount of relevant profits against which carried-forward losses can be set for the general loss restriction, and in order to align the definitions of relevant profits for the two measures it will be taken into account for the bank loss restriction. The government has taken steps to simplify the economy-wide loss relief calculation, from which banking companies will also benefit. The change in the apportionment of in-year losses will also apply to the bank loss restriction. More details of the amended calculations are found under the 'Loss relief calculation' section and Annex A.

5.19 As set out in the consultation document, the government will amend bank surcharge legislation so that carried-forward losses generated from a non-banking company are disregarded in the calculation of profit subject to the surcharge. This will ensure the bank surcharge continues to apply to the taxable profit of banking companies before the effect of losses surrendered from non-banking companies within the group.

5.20 The Bank Loss Restriction will continue to not apply to losses covered by the allowance for building societies and losses incurred by companies in the first five years of their group carrying out banking activity. However, the use of these losses will be subject to the general loss restriction, and be limited to 50% of total profits.

North Sea Oil & Gas regime

5.21 Respondents welcomed the exclusion of ring fence activities from the loss relief reforms. A few respondents suggested extending the increased flexibility, so ring fence losses could be surrendered to other ring fence profits within the group when an oil field ceases to be profitable.

Government response:

5.22 Following consultation with industry on the treatment of ring fence activities, the government will legislate to ensure the oil and gas regime remains robust to the loss relief reforms. The general principles include allowing ring fence losses to be carried forward against the same company's ring fence profits without restriction. However, if ring fence losses are used against non-ring fence profits then (subject to specific exclusions) these losses will be subject to the loss relief reforms. Non-ring fence losses are subject to the loss relief reforms and cannot be set against ring fence profits. The legislation will ensure that:

- carried-forward ring fence decommissioning losses can be set against future ring fence profits of the same company, and those arising from related activities outside the ring fence, without restriction
- carried-forward ring fence non-decommissioning losses can be set against future ring fence profits of the same company without restriction, but when set against profits from non-ring fence related activities, these will be restricted
- carried-forward ring fence decommissioning losses cannot be set against ring fence profits of group companies
- carried-forward ring fence decommissioning losses cannot be set against non-ring fence profits of the same company (other than of related activities) or group companies
- carried-forward ring fence non-decommissioning losses cannot be set against ring fence profits of group companies
- carried-forward ring fence non-decommissioning losses can be set against non-ring fence profits of the same company and group companies, but these will be subject to both restriction and relaxation
- carried-forward non-ring fence trade losses cannot be set against ring fence profits

5.23 "Ring fence losses" are those that arise from oil and gas activities that are treated as a separate trade within section 279 CTA 2010. "Decommissioning losses" are losses arising from ring fence activities that are attributable to decommissioning costs.

5.24 In addition, the government will introduce a general rule to ensure the only losses that arise from ring fence activities can be set against ring fence profits.

Real estate investment trusts (REITs)

5.25 The REIT regime grants an exemption from corporation tax to companies for the profits of their property rental business, conditional on 90% of the UK property rental profits being distributed to the REIT shareholder every year. Some respondents proposed REITs should be exempt from the reforms all together on the basis that they will not benefit from the relaxed streaming rules, the restriction could artificially inflate the profit distribution requirement and that the purpose of a REIT is to tax the shareholders more directly.

Government response:

5.26 The government recognises this unintended consequence of the policy and will legislate to exclude REITs from the loss relief reforms.

UK furnished holiday lettings

Government response:

5.27 Under current legislation losses arising from UK furnished holiday lettings are already restricted in their use and can only be carried forward and set against future furnished holiday lettings or surrendered as group relief. The government does not intend to disturb this treatment and will not bring UK furnished lettings within the scope of the loss relief reforms.

Creative industry tax reliefs

Government response:

5.28 Creative industry tax reliefs allow certain qualifying production/development companies involved in activities such as television and making films to claim additional deductions in computing their corporation tax profits. Under the loss relief reforms, the treatment of losses arising to these companies will depend on when the loss arises, in particular whether the loss arises before or during the "completion period" (the accounting period in which the production is completed.) Losses arising before the "completion period" are restricted under current legislation in the way in which they can be used and will therefore not be brought within the scope of the measure. However, losses arising during the "completion period" will be both restricted and relaxed.

Consortia

5.29 Respondents broadly welcomed applying the increased flexibility of the loss relief reforms to consortium relief, but had concerns over the complexity it would bring. Most respondents who commented on consortia suggested the amount of losses that could be surrendered out of the company owned by a consortium (referred to here as a 'consortium company') should be based on the member's interest at the time of surrender, with fewer respondents suggesting losses should be tracked over time, so to ensure members could only surrender losses proportionate to those they had incurred.

5.30 Some respondents mentioned that a consortium company should be treated as a normal company as part of a group, but subject to its own £5 million allowance. A handful also proposed there should be no bespoke rules for consortia, adding they would be unnecessary due to any flexible use of losses being reflected in the commercial arrangements between the members of the consortia. Some respondents thought the requirement for all members of a consortium to agree to a consortium relief for carried-forward losses claim was excessive, believing this to not be a requirement for the existing consortium relief rules.

5.31 Some suggested that anti-avoidance legislation would be needed to protect against loss buying and other avoidance risks. More generally, some would like more clarity and detail on this issue.

Government response:

5.32 The government's proposal is that losses of a consortium company will be available for surrender as consortium relief for carried-forward losses to members of a consortium according to the member's interest in the consortium company in the accounting period in which the loss arose. Where a company ceases to be a member of a consortium, it will lose the ability to claim any of the consortium company's losses.

5.33 The proposal for consortia is that the maximum losses a member of a consortium can claim will be capped at the entitlement it had in the period the loss arose, and that this entitlement will not be recalculated where some of the losses are used. For example, two consortium members, Company A and Company B, each own 50% of a consortium company and the consortium company makes a loss in the accounting period ending 31 December 2018 of £100,000. Each consortium member can claim a maximum of £50,000 of the losses. The loss is not used in the accounting period in which it arose so is carried forward to the following period. If in the accounting period ending 31 December 2019 the consortium company uses £25,000 of its losses of the previous period, the maximum losses that each consortium member can claim is still capped at £50,000 each. Therefore the consortium members and the consortium company could decide that Company B can claim its entire cap of £50,000. This would leave losses of £25,000 available. Although Company A has a cap of £50,000, it will not be able to claim more than the remaining £25,000.

5.34 The government recognises that the approach to companies within a consortium may lead to complexity since losses must be tracked according to the year in which the loss arose. However, an approach based on allowing consortium members to claim losses according to their interest in a consortium company in the year in which they make a claim for relief would enable companies to engage in loss buying. In discussions during the consultation period, most respondents said they would rather the extra administrative burden over not being able to use the losses more flexibly. The requirement, outlined in the consultation document, for all members of a consortium and the consortium company to agree to a consortium relief for carried-forward losses surrender matches the existing requirement for consortium relief and so is consistent with the current rules.

5.35 As with the existing consortium relief provisions, a consortium company will be required to use its carried-forward losses as far as possible and then surrender them to companies in its group before the losses can be surrendered to consortium members.

5.36 A consortium company is likely to not meet any of the tests of a group for the purposes of the allowance and therefore be entitled to its own £5 million allowance, to be shared with any companies with which it is in a group.

Double taxation relief (DTR)

5.37 A few respondents noted that the apportionment of trading and non-trading profit in the carried-forward loss relief calculation could limit businesses' ability to fully utilise their DTR. It was also noted that the foreign branch exemption election could affect the impact of the loss restriction.

Government response:

5.38 Due to feedback from respondents about the complexity of the loss relief calculation, the government has proposed a simplified calculation. Companies will now have more flexibility in how in-year reliefs are notionally set against trading and non-trading profits. More details on this can be found under the 'Loss relief calculation' section or at Annex A. This apportionment is for the purposes of the loss restriction calculation only and will not have an impact on a company's ability to claim DTR.

5.39 During the consultation process, the government recognised the potential for companies to elect for otherwise exempt non-trading dividend income to be taxable (with the UK corporation tax liability covered by DTR) for the purpose of inflating profits and diluting the loss restriction. The government will therefore exclude non-trading dividends from the calculation of the loss restriction. The generous distribution exemption means it is unusual for companies to elect for their non-trading dividend income not to be exempt from UK corporation tax.

Research & Development tax credits (R&D)

5.40 Some respondents noted that R&D tax credits are calculated with reference to trade losses, and that there is no indication of how the credit will be calculated under the new loss relief rules. More generally, respondents said that tax incentives around R&D, and other reliefs such as for the creative sector, should not be impacted.

Government response:

5.41 The payable tax credit for the surrender of losses only applies to in-year losses, so is unaffected by these reforms. The super-deduction of R&D expenditure, which may increase carried-forward losses, is only relevant for SME companies. The government expects the majority of those companies within the SME R&D scheme to have their losses covered by the £5 million allowance and so to not be affected by the restriction. The R&D expenditure credit (RDEC) is based on R&D expenditure, rather than losses, so its calculation is not affected by the loss relief reforms and the monetary benefit of the RDEC is unchanged.

Patent Box

5.42 Some respondents wanted clarity that the reforms would have no unintended impacts on the policy intention of the Patent Box.

Government response:

5.43 Patent Box losses, whilst identified separately, are still included in a company's general trading losses and so the loss relief reforms will apply to those losses. The government has considered the application of the loss relief reforms to Patent Box losses and does not consider that there is an impact on the policy intention of the Patent Box.

Tax deductibility of corporate interest expense

5.44 Some respondents requested clarification on the interaction between the corporate interest expense deductibility changes and the loss relief reforms, particularly around trading and non-trading interest.

Government response:

5.45 Interest expenses are treated as deductions for corporation tax purposes, and as such are taken into account before the loss relief restriction is calculated.

Northern Ireland

5.46 One respondent noted the interaction between the Northern Ireland corporation tax (NICT) regime and the wider UK regime.

Government response:

5.47 The Corporation Tax (Northern Ireland) Act 2015 allows for devolution of power to the Northern Ireland Assembly to set a separate rate of corporation tax over certain trading profits arising in Northern Ireland and legislates for the Northern Ireland corporation tax (NI CT) regime. The government is committed to commencing the NI CT regime if the Northern Ireland Executive demonstrates its finances are on a sustainable footing. The Northern Ireland Executive has publicly indicated its intention to set a rate of 12.5% in April 2018.

5.48 The government published draft technical guidance on 26 September 2016 setting out how the NICT regime would be implemented[1].

5.49 Full details of how the existing loss relief rules will interact with the NI CT regime can be found at sections NICT02030 to NICT02035 of the draft technical guidance.

[1] 6.42 www.gov.uk/government/publications/northern-ireland-corporation-tax-regime-draft-guidance

5.50 The loss relief reforms will apply to the NI CT regime, meaning that Northern Ireland losses will be subject to both the loss restriction and the increased flexibility of carried-forward losses.

Loss carry-back

5.51 Respondents sought clarity on how loss carry back mechanisms would work under new rules for carried-forward losses, with some proposing increased flexibility in how loss carry back is used.

Government response:

5.52 The existing loss carry back rules will continue as previously, and will apply to in-year losses only. The government will legislate for increased flexibility for where a business ceases trading and has unutilised carried-forward losses, more details on this proposal can be found in the 'Unintended consequences' chapter.

Companies with multiple trades

5.53 One respondent sought clarity on the streaming rules where a company has pre-2017 losses arising from multiple trades.

Government response:

5.54 The government will only increase the flexibility for losses incurred on or after 1 April 2017. Companies cannot currently set the carried-forward losses from one trade against the profit of another trade, and under the reforms this will still be the case for pre-2017 trading losses.

A Revised loss relief calculations

Calculation 1 – for companies that use any pre-April 2017 trading losses or pre-April 2017 non-trade loan relationship deficits (NTLRDs)

Step 1 – Calculate the amount of profits to which the restriction applies

- calculate the company's total profits for the accounting period, excluding any restricted carried-forward losses
- calculate the amount of in-year relief available against total profits
- divide total profits into trading and non-trading. Apply the in-year relief available against total profits to trading and non-trading profits at the company's discretion
- allow up to £X million of profit to be relieved in full by available carried-forward losses, with X representing the amount of the £5 million group-level allowance that is allocated to the company. The group and company have full discretion in how this is allocated, e.g. the full allowance could be allocated to the trading profits of one particular company, and meaning up to £5 million of carried-forward losses could be set against those profits in full

Step 2 – allow up to 50 percent of remaining profit to be relieved by pre-April 2017 carried-forward losses (that have not been carried forward to the next accounting period subject to existing streaming rules)

- allow up to 50% of the trading profit remaining after Step 1 to be relieved with available carried-forward pre-April 2017 trading losses and up to 50% of the non-trading profit remaining after Step 1 to be relieved with available carried-forward pre-April 2017 NTLRDs
- add together trading and non-trading profits remaining after Step 1 to establish the company's Relevant Total Profits

Step 3 – allow losses to be relieved against total profits

- to the extent that losses already claimed at Step 2 fall below 50% of Relevant Total Profits, allow remaining profits to be relieved by available management expenses, UK property losses, non-trading losses on intangible fixed assets, post-April 2017 trading losses and post-April 2017 NTLRDs. The order of use of the losses is at the company's discretion
- if there are still Relevant Total Profits available that can be relieved within the 50% restriction, allow this profit to be relieved by post-April 2017 carried-forward losses of any type that have been claimed from other companies in the group
- if the company has relieved its Relevant Total Profits up to the 50% limit but there are remaining post-April 2017 carried-forward losses within the company, allow these losses to be surrendered to other companies to other companies that have surplus capacity

Calculation 2 – where a company uses neither pre-April 2017 trading losses nor pre-April 2017 NTLRDs

Step 1 – calculate the amount of profits to which the restriction applies

- calculate the company's total profits for the accounting period excluding any restricted carried-forward losses
- calculate the amount of in-year relief available against total profits
- allow up to £X million of profits to be relieved in full by available carried-forward losses, with X representing the amount of the £5 million group-level allowance that is allocated to the company. The group and company have full discretion in how this is allocated, e.g. the full allowance could be allocated to the total profits of one particular company meaning that up to £5 million of carried-forward losses could be set against those profits in full

Step 2 – allow up to 50% of remaining profit to be relieved by carried-forward losses

- the profits remaining after Step 1 are the company's 'Relevant Total Profits'. Allow up to 50% of the profits remaining after Step 1 to be relieved with available carried-forward post-April 2017 trading losses, post-April 2017 non-trading loan relationship deficits, management expenses, property losses and non-trading losses on intangible fixed assets. The order of use of the losses is at the company's discretion

Step 3 – allow losses to be surrendered between group companies

- if there are still Relevant Total Profits available that can be relieved within the 50% limit, allow this profit to be relieved by post-April 2017 carried-forward losses of any type that have been claimed from other companies within the group
- if the company has relieved its Relevant Total Profits up to the 50% limit but there are remaining post-April 2017 carried-forward losses within the company, allow these losses to be surrendered to other group companies that have surplus capacity

Calculation 3 – for banking companies that use any trading losses or NTLRDs that are subject to the bank loss restriction (BLR)

Step 1 – calculate the amount of profits to which the restriction applies

- calculate the company's total profits for the accounting period excluding any restricted carried-forward losses
- calculate the amount of in-year relief available against total profits
- divide total profits into trading and non-trading. Apply the in-year relief available against total profits to trading and non-trading profits at the company's discretion
- allow up to £X million of profit to be relieved in full by available carried-forward losses, with X representing the amount of the £5 million group-level allowance that is allocated to the company. The group and company have full discretion in how this is allocated, e.g. the full allowance could be allocated to the trading profits of one particular company meaning that up to £5 million of carried-forward losses

could be set against those profits in full. Losses subject to the BLR cannot be used at this point

Step 2 – allow up to 25% of remaining profit to be relieved by carried-forward BLR losses and up to 50% of remaining profit to be relieved by pre-April 2017 carried-forward losses subject to the existing streaming rules

- allow up to 25% of the trading profit remaining after Step 1 to be relieved with available carried-forward BLR trading losses and up to 25% of the non-trading profit remaining after Step 1 to be relieved with available carried-forward BLR non-trading loan relationship deficits
- to the extent that losses already used fall below 50% of trading profits remaining after Step 1, allow remaining profits to be relieved by available pre-April 2017 trading losses. To the extent that losses already claimed fall below 50% of non-trading profits remaining after Step 1, allow remaining profits to be relieved by available pre-April 2017 NTLRDs
- add together trading and non-trading profits remaining after Step 1 to establish the company's 'Relevant Total Profits'

Step 3 – allow losses to be relieved against total profits

- to the extent that losses already claimed at Step 2 fall below 25% of the Relevant Total Profits, allow remaining profit to be relieved by available BLR management expenses
- to the extent that losses already claimed fall below 50% of the Relevant Total Profits, allow remaining profits to be relieved by available management expenses, UK property losses, non-trading losses on intangible fixed asset, post-2017 trading losses and post-2017 non-trading loan relationship deficits. The order of use of the losses is at the company's discretion
- if there are still Relevant Total Profits available that can be relieved within the 50% limit, allow this profit to be relieved by post-April 2017 carried-forward losses of any type that have been claimed from other companies in the group
- if the company has relieved its Relevant Total Profits up to the 50% limit but there are remaining post-April 2017 carried-forward losses within the company, allow these losses to be surrendered to other group companies that have surplus capacity

Calculation 4 – for banking companies that do not use any pre-April 2017 trading losses or pre-April 2017 NTLRDs but use management expenses that are subject to the BLR

Step 1 – calculate the amount of profits to which the restriction applies

- calculate the company's total profits for the accounting period excluding any restricted carried-forward losses
- calculate the amount of in-year relief available against total profits. Deduct this amount from total profits
- allow up to £X million of profit to be relieved in full by available carried-forward losses, with X representing the amount of the £5 million group-level allowance that

is allocated to the company. The group and company have full discretion in how this is allocated, e.g. the full allowance could be allocated to the total profits of one particular company meaning that up to £5 million of carried-forward losses could be set against those profits in full

Step 2 – allow up to 25% of remaining profit to be relieved by BLR management expenses and up to 50% of remaining profit to be relieved by other carried-forward losses

- the profits remaining after Step 1 are the company's 'Relevant Total Profits'. Allow up to 25% of the Relevant Total Profits to be relieved with available carried-forward BLR management expenses
- to the extent that losses already used fall below 50% of Relevant Total Profits, allow Relevant Total Profits to be relieved with available carried-forward post-April 2017 trading losses, post-April 2017 NTLRDs, management expenses, property losses and non-trading losses on intangible fixed assets. The order of use of the losses is at the company's discretion

Step 3 – allow losses to be surrendered between group companies

- if there are still Relevant Total Profits available that can be relieved within the 50% limit, allow this profit to be relieved by post-April 2017 carried-forward losses of any type that have been claimed from other companies in the group
- if the company has relieved its Relevant Total Profits up to the 50% limit but there are remaining post-April 2017 carried-forward losses within the company, allow these losses to be surrendered to other group companies that have surplus capacity

B List of respondents

- 100 Group
- Aegon
- Ashurst LLP
- Associated British Ports
- Association for Financial Markets in Europe
- Association of Accounting Technicians
- Association of British Independent Oil Exploration Companies
- Association of British Insurers
- Association of Business Recovery Professionals
- Association of Chartered Certified Accountants
- Association of Taxation Technicians
- AstraZeneca
- Aviva
- Bombardier
- BP
- British Land
- British Private Equity & Venture Capital Association
- British Property Federation
- Caterpillar
- Centrica
- Chartered Accountants Ireland
- Chartered Institute of Taxation
- City of London Law Society
- Confederation of British Industry
- Cooley (UK) LLP
- Cross London Trains
- Cubico
- Deloitte
- EY
- EY (on behalf of PPP investors)

- Eurostar
- FTI Consulting
- G4S
- Goodman Group
- Grant Thornton
- Greater London Authority
- Heathrow Airport
- High Speed 1
- HKO Mercury
- Honda
- Institute and Faculty of Actuaries
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants of Scotland
- International Underwriting Association of London
- Investment and Life Assurance Group
- James Marson
- Johnston Carmichael
- KPMG
- Ladbrokes
- Law Society of England and Wales
- Legal & General
- Lehman Brothers
- London Legacy Development Corporation
- London Society of Chartered Accountants
- Moore Stephens LLP
- Northern Ireland Water
- Old Oak and Park Royal Development Corp
- Phoenix Group
- Pinsent Masons LLP
- PPP Forum
- PwC
- PwC (as administrators of various companies)

- Prudential
- Randall & Payne LLP
- Rolls Royce
- Royal Institute of Chartered Surveyors
- RSA Insurance Group Plc
- RSM UK
- Sage UK
- Scottish Water
- Segro
- Slaughter and May
- Standard Life Plc
- Sony
- TheCityUK
- Vinci Plc
- Virgin Money Plc
- Weil, Gotshal & Manges

C Draft legislation

C.1 Draft legislation for the core rules of the loss relief reforms can be found alongside this response to the consultation. The government intends to publish the remaining draft legislation for consultation by the end of January 2017. Consequential amendments including those for the Northern Ireland Corporation Tax regime will be published at Finance Bill.

Draft legislation publication dates

5 December	Subsequent publication
Loss restriction calculation	Group relief for carried-forward losses – application to companies in a consortium
Annual £5 million allowance, including the definition of a group for the purposes of the allowance	Anti-avoidance provisions
Amendments to the Bank Loss Restriction	Basic Life Assurance and General Annuity Business
Loss relaxation rules at company level	Oil and Gas
Group relief for carried-forward losses – application to group companies	Real Estate Investment Trusts
Terminal carried-forward loss relief	Creative Industries
Commencement provisions	UK furnished holiday lettings
Exclusion of non-trading dividends from profits for the loss restriction	

HM Treasury contacts

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