



Response from ICAS

Reforms to corporation tax loss relief: consultation on delivery

17 August 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to contribute to the consultation "Reforms to corporation tax loss relief: consultation on delivery" issued by HMT and HMRC on 26 May 2016.
3. The proposed changes to the loss relief rules will enable companies to set carried forward losses arising from 1 April 2017 against taxable profits of different activities within a company and the taxable profits of its group members. This can be seen as simplification for smaller companies and groups, although this is compromised by the retention of the old rules for losses incurred before 1 April 2017.
4. The Office of Tax Simplification (OTS) is currently conducting a review of the corporation tax computation and is due to report before Budget 2017. The basis of the OTS project is that simplification of the tax computation is desirable and the review will consider the treatment of different sources of company income, and the legislative and practical complexities arising. It does not make sense to go ahead with major changes to corporate loss relief before the OTS has completed its review of the corporate tax computation. The changes, as proposed, will introduce more complexity for the largest companies, undermining the OTS project before it even reports.
5. We agree with the principle (set out in paragraph 1.13 of the consultation document) that relief for carried-forward losses is an important feature of the tax system, ensuring that the tax paid by a company is reflective of its profit over the long term. Whilst we understand that there is an impact on the Exchequer, as set out in paragraph 1.16, the proposals to restrict loss relief clearly undermine the important principle in 1.13. Businesses have to take a long term view and take some risks to ensure the economy continues to grow – an overall profit over the business cycle may mean losses in some accounting periods but profits in others. Whilst the tax system should not encourage excessive or unmanaged risk-taking, equally it should not discourage managed risk-taking, which is vital for long term prosperity.
6. The restrictions on the amount of annual profit that can be relieved by carried forward losses will have a significant negative impact on the largest companies and groups. These companies are already facing a period of uncertainty arising from the decision to leave the EU. They will also have to deal with the effect of the restrictions on interest deductibility, subject to the outcome of the separate consultation. Whilst we recognise that corporation tax rates have been reduced in recent years some of our members are now concerned that continuing reductions are being pursued at the expense of certainty and stability. We have not seen any evidence that there is demand for further CT rate reductions, if the price is more complexity in the compliance process. The changes to the rules on losses were unexpected, they are complex and will mean affected companies revising their forecasts again. This is unhelpful for investors and such frequent and unpredictable changes could deter foreign investment rather than encouraging it. There needs to be a sensible balance between reducing rates and counterbalancing changes, such as these proposed changes to losses, which may have detrimental results.
7. The consultation document notes that over 99% of companies will not be affected by the restriction due to the £5 million allowance. However, the 1% of companies that will be affected represent a sizeable part of the economy. In practice, smaller companies will also be affected indirectly if the effect of the new rules is that the 1% subject to the restriction respond by scaling back their activities to limit risk and hence reduce the amount of work they provide to SMEs. A proper impact assessment should be carried out to ascertain the likely impact of the proposal on the companies affected and hence on the wider economy.
8. If the government is not prepared to reconsider the restrictions for larger companies, implementation should at least be deferred to allow companies time to deal with the immediate consequences of

Brexit and until the OTS recommendations on the complete picture of the corporation tax computation are available. The rules should be made simpler and there should be OTS input in developing them. As the computational examples in the consultation document illustrate, the calculations currently proposed for common group situations will be excessively complicated. Delaying implementation will permit further consultation on the details and proper consideration of the draft legislation. The current proposed timetable is inadequate.

9. The £5m allowance per group that can be relieved without the need to consider the restriction is helpful. However, it is important that it is indexed, or regularly reviewed, to ensure that its value is not eroded over time bringing more companies within the restrictions.

Specific questions

Q1. Will the proposed model be effective in delivering the objective of allowing businesses greater flexibility in the use of carried-forward losses?

For smaller companies, unaffected by the restriction on profits which can be relieved, the model should provide some extra flexibility in the use of carried-forward losses. However, the retention of the old rules for carried forward losses relating to periods prior to April 2017 undermines the flexibility, even for these companies. Once these losses are exhausted the position will improve for companies unaffected by the new restriction.

As noted in our general comments, for companies affected by the restriction of loss relief the impact is likely to be negative. Increased flexibility arising from the ability to set off brought forward losses against the profits of different activities is likely to be negated or diminished by the restriction of profits eligible for relief. Additionally, the calculations are excessively complex and will occupy a disproportionate amount of business time.

Q2. Could the calculation be made simpler or more effective?

The three step calculation leads to excessive complexity, as can be seen by consideration of example 5 in the consultation document. As noted in our general comments we believe that reform of corporate loss relief should be considered as part of a wider package of reforms and should take account of the findings of the OTS review.

It would be useful to have clarification that the normal rules for group relief will not be altered. For example: trading losses (and certain other types of loss) can currently be surrendered, wholly or in part, as group relief rather than being set off against the company's own profits of the current accounting period. Will this remain unchanged?

Q3. To what extent does this proposed model provide an effective means of applying the existing and proposed loss restriction rules to the banking sector?

We have no comments in relation to this question.

Q4. Could the calculation be made simpler or more effective?

We have no comments in relation to this question.

Q5. Is there any reason why the definition of a group for the surrender of carried-forward losses shouldn't be aligned with the existing group relief definition?

No. We agree that the definition should be aligned with the existing group relief definition; as noted in the consultation this definition is familiar and relatively simple to apply.

Q6. What definition of a group should be used for the purposes of applying the £5 million allowance?

The proposal that a different definition of group should be used for the purposes of the £5 million allowance adds additional complexity to already complex rules. There are already multiple definitions of a group for different parts of the tax legislation. One possibility might be to review all these definitions and to consult on possible standardisation across tax legislation; this could be another project for the OTS.

Otherwise the same definition should be used for the surrender of carried-forward losses and for the purposes of applying the £5 million allowance. The consultation document seems to envisage difficulties which are unlikely to arise in practice or could be addressed whilst still using the same definition.

Q7. How should the reforms be applied to consortia relationships?

Subject to our comments on the complexity of the proposals we consider that the suggested approach to consortia broadly makes sense but until draft legislation is available we have no detailed comments.

Q8. How could the legislation be protected from abuse in a way that is simple and administrable for businesses?

The consultation document notes that there are already targeted anti-avoidance rules dealing with tax motivated refreshing of carried-forward losses. We agree that it would make sense to ensure that the other losses mentioned in paragraph 5.20 are covered by these rules.

However, it seems unlikely that adding new anti-abuse rules will be simple and administrable for businesses. The possibility of profit shifting referred to in paragraph 5.21 already exists, although we recognise that there is at least a theoretical possibility that the new rules might increase the incentives for doing it. There are already anti-avoidance rules to tackle profit shifting so we question the need for more. Complexity and TAARs lead to attempts to find and exploit loopholes, leading to more TAARs and additional complexity.

Q9. Do you have any concerns regarding the government's proposed approach to loss-buying and trade cessation?

The existing rules (in Part 14 CTA 2010) which restrict losses where there is a major change in the nature or conduct of a trade/business or the trade/business has become negligible should be retained.

There could be scope for loss buying for post April 2017 losses, which will be eligible for the new flexibility, but the proposal to restrict carried forward losses to the profits of the same trade/business on changes of ownership (ie to remove all of the new flexibility) is too onerous. The additional uncertainty might inhibit the sale/purchase of companies in genuine commercial transactions. If some streaming is regarded as essential there would appear to be no reason to restrict flexibility where the ownership of a group of companies changes: in this scenario it should remain possible for companies within the acquired group to continue to benefit from the new flexibility.

Paragraph 5.26 of the consultation document asks for views on the extent to which a group should be able to relieve its carried-forward losses against the profits of a company it acquires and how such flexibility could be safeguarded from abuse. We consider that profit buying is much harder to achieve than loss buying. It is unlikely that many companies with large losses in excess of £5 million would be in a position to purchase a profitable company (assuming they could identify one) at a price they would be prepared to pay, solely for the purpose (or even with a main purpose) of using some of their existing losses. This contrasts with loss buying where (absent the various anti-avoidance provisions) it might be possible to buy a company for its tax losses, paying a price based on the value of those losses, rather than purchasing it for its underlying economic activity (unless the intention was to turn it round which would then be the main purpose rather than loss buying). However, we recognise that the new rules could create some scope for financial engineering for avoidance purposes; this could be addressed by the inclusion of a sole or main benefit test.

Q10. Are there other areas of the tax system with which these rules would have a significant impact? If so, what are these, and what might the consequences of that impact be?

We have no comments in relation to this question.

Q11. Do you have views on the government's proposed approach to oil and gas and life insurance companies?

Oil and gas:

We agree that the reforms should not apply to carried-forward losses relating to ring-fenced oil and gas activity.

Life insurance:

We agree that it is appropriate not to apply the reforms to excess Basic Life Assurance and General Annuity Business (BLAGAB) expenses. The BLAGAB I-E regime collects basic rate policyholder tax due on policyholder investment return as part of the life insurer's corporation tax computation. It would not be appropriate to extend these proposed loss reforms to BLAGAB because they would probably adversely impact policyholder returns and require changes in policy conditions, the BLAGAB I-E legislation and possibly the Chargeable Events rules (which collect policyholder higher rate tax). Such changes could only be part of a fundamental review of the BLAGAB I-E system.

Q12. What impact could the reforms have on public-private partnership or private finance initiative projects?

These projects are long term and often make losses in the earlier years. The losses are expected to be offset over the life of the project and this is factored into the pricing. The reforms could therefore adversely affect the commercial viability of existing projects by slowing down the expected loss relief. Consideration should be given to the inclusion of a grandfathering exception from the new rules for projects already in progress.

New projects will be more expensive with a possible adverse impact on affordability. A detailed impact assessment should be carried out and consideration given to the introduction of a public benefit exemption.

Q13. What other sectors or specialist areas of taxation need consideration as part of these reforms?

Large capital expenditure/infrastructure projects not covered by Q12. In particular, some of these projects may be taking advantage of 100% enhanced capital allowances in Enterprise Zones. Imposing a restriction on loss relief for such projects runs counter to the policy of encouraging investment through the availability of enhanced capital allowances.

Q14. What will be the impact of the reforms on insurers' regulatory capital?

The impact of the reforms will be to require insurers to hold additional regulatory capital which will most likely need to be funded by shareholders. In calculating the Solvency Capital Requirement (which is the capital required to meet a 1 in 200 year shock loss) it is assumed there is a tax loss equal to the shock loss. To the extent this creates a deferred tax asset that can be demonstrated to be recoverable, it acts to reduce the Solvency Capital Requirement. To demonstrate recoverability of the deferred tax asset, insurers look to project future profits. The impact of the reforms will be to almost double (ignoring the impact of the £5m "tax free" amount which is on the margins in these calculations) the projection period, which makes it far harder to justify the deferred tax asset recovery. ICAS is aware of one life insurer where the impact of these reforms is to increase the Solvency Capital Requirement in excess of £100m which is quite clearly a material amount.

It should not be a consequence of these reforms that additional capital needs to be held for solvency purposes. It ought to be possible to achieve a carve out for insurers, which would not impact other taxpayers, where the tax losses arise from the 1 in 200 year shock event. This could be, for example, by reference to Article 207 of Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 (http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AJOL_2015_012_R_0001) which sets out the adjustment to be made for the loss absorbing capacity of deferred taxes.

Q15. To what extent could the reforms impact on the business plans of new-entrant companies?

Post Brexit the government has been keen to stress that Britain is still open for business and presumably wishes to encourage entrepreneurial businesses to set up in the UK. As the consultation document notes, in paragraph 6.9, start-up companies are liable to make losses when breaking into a market. This underlines the importance of the principle (set out in paragraph 1.13 of the consultation document) that relief for carried-forward losses is important in ensuring that the tax paid by a company is reflective of its profit over the long term. It is hard to see that the proposals can be anything other than a deterrent to start-up companies. Consideration should therefore be given to an exemption from the loss restriction rules for standalone start-up companies, for a specified period. To limit possible abuse, the exemption would only continue to be available whilst the company remained a singleton company and would be lost if the company was taken over by another company or group.