ICAS comments on Draft Finance Bill Clause 20 and Schedule 6

1 February 2017
About ICAS

1. 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.

2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

Comments

3. ICAS welcomes the opportunity to comment on the draft legislation.

4. In view of the very short time allowed for comment and the publication of the legislation in two stages (making it difficult to consider the complete picture) we strongly suggest that the new corporate loss provisions should be subject to a formal short term review by HMRC and the government, so that issues which arise post-implementation can be addressed quickly through amendments to the legislation.

50% Profit Restriction

5. The Business Tax Roadmap published by HM Treasury in March 2016 stated (paragraph 2.58) that “the government will restrict the amount of taxable profit that can be offset through losses carried forward” so that from 1 April 2017, after the £5m allowance “the government will restrict to 50% the amount of profit that can be offset through losses carried forward”.

6. However, the effect of the draft legislation is to restrict, in some circumstances, the set off to below 50% of the taxable profit. This can be seen in the following example.

7. A company has current year profits as follows:

<table>
<thead>
<tr>
<th>Profit Type</th>
<th>Profit Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trading</td>
<td>45m</td>
</tr>
<tr>
<td>Non-trading</td>
<td>60m</td>
</tr>
<tr>
<td>Total</td>
<td>105m</td>
</tr>
</tbody>
</table>

The company has brought forward pre-April 2017 trading losses of £50m. Pre-April 2017 losses fall outside the new flexibility so trading losses must be set against trading profits.

8. Based on the policy intention set out in the roadmap the expectation was that the restriction to loss relief would be based on the total current year taxable profits of £105 million. This would mean the maximum possible offset of losses would be limited to £55 million (i.e. the £5 million allowance plus 50% of remaining total profits of £100 million), subject to there being sufficient losses available to offset those profits and taking account of the streaming rules where relevant.

9. However, under the model in the draft legislation the offset of trading losses would be restricted to a total of £25 million (i.e. the £5 million allowance fully allocated against the trading profit, plus 50% of remaining trading profits of £40 million). This means that 24% of profits rather than the expected 50% can be offset. The pre-April 2017 losses are restricted under the ‘old’ loss rules but are then further restricted under the new rules.
Distressed Companies

10. Paragraph 3.8 of the response document records that some respondents expressed concerns about the impact of the restriction on companies in distress. Restructurings frequently generate material one-off credits. These often relate to financial restructurings and are catered for by the loan relationships exemptions. However, there are cases where the credit is fully taxable, for example, a credit arising when a Company Voluntary Arrangement is used to negotiate rent reductions from landlords.

11. Responses to the consultation asked the government to consider adopting a ‘corporate rescue exemption’ (similar to that available for financial restructurings in s322(5B) CTA 2009) for both the proposed £5 million allowance and the 50% restriction on the deduction of carried forward losses. This suggestion was rejected.

12. We remain concerned that many restructurings that might save distressed businesses may not be pursued in future, as a direct consequence of the tax liability that will now arise. If these restructurings went ahead without some form of tax relief only 50% of the income could potentially be sheltered by losses.

13. If a general corporate rescue exemption is unacceptable, we suggest instead that the government should consider extending the insolvency exemption referred to in paragraph 11 above and removing the 50% restriction on the use of losses where taxable income arises directly from steps that are part of a statutory insolvency arrangement (as defined in s1319 CTA 2009).