



ICAEW REPRESENTATION 125/16

TAX REPRESENTATION

REFORMS TO CORPORATE TAX LOSS RELIEF

ICAEW welcomes the opportunity to comment on the consultation on delivery of [Reforms to corporation tax loss relief](#) published jointly by HM Treasury and HM Revenue & Customs on 26 May 2016.

This response of 16 August 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

On 28 July 2016 we attended a meeting with HM Treasury / HMRC jointly with other professional bodies in which we were able to put forward some key comments and concerns and discuss aspects of the consultation document.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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For more information, please contact ICAEW Tax Faculty: taxfac@icaew.com

icaew.com

MAJOR POINTS

Key point summary

1. We have concerns that the proposals which introduce greater flexibility in the use of carry forward losses only apply to losses arising post April 2017 whereas the restricted use of losses, to set off against only 50% of future profits, applies to losses arising pre April 2017.
2. Whatever changes are introduced we suggest they should apply to accounting periods beginning after April 2017 to avoid complicated transition provisions.

RESPONSES TO 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?

3. We support the greater flexibility for the relieving of post April 2017 losses. We do however have some concerns about the cap of 50% of profits being available for relief from losses brought forward as this will detract from companies getting relief from losses except in the longer term. This proposal clearly restricts flexibility and could cause considerable issues for companies in distress, even potentially pushing them into an insolvent position as a result. It also does not seem reasonable to restrict losses where a company has a short term difficulty due to, for example, being in a start-up position or facing difficult trading conditions or expansion requirements into new markets/products.
4. We also believe it is inappropriate that, if a 50% restriction is to be introduced, it apply to all losses whereas the benefit of using carried forward losses more widely is restricted to losses arising after April 2017. The 50% restriction alone ensures that there should not be a significant hit to the Exchequer in allowing the flexible carried forward loss approach to apply to all losses. Indeed, it seems likely that the combined changes will increase revenues to the Exchequer and so it may be inappropriate to badge this as an improvement to flexibility unless the two changes can, at least, be applied consistently. The current proposal, instead, increase tax for many companies and is overly complex to operate such that these companies might struggle to see it as a positive change.

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

5. Firstly, we would recommend that the changes apply to periods beginning after April 2017 rather than by reference to losses after this date since, otherwise, additional complexity is required to deal with straddle periods.
6. However, even with this change, the rules are complex and, in particular, the need to offset current year losses before dealing with carried forward losses is a significant restriction compared to the current rules. It also means that current year (unrestricted) losses are used before pre April 2017 losses which is contrary to the stated intention in the consultation document to allow pre April 2017 losses to be used as a priority. So we believe that, as a minimum, the proposals ought to be amended in this respect to allow companies to retain the current flexibility to choose the order of offset of current year and brought forward losses.
7. However, as mentioned above, we do not believe there is a need to restrict the wider use of carried forward losses to only losses arising after April 2017. Both proposals should apply to all losses. The complex ordering set out in the consultation document is only required because of the current proposal to limit the positive change to post April 2017 losses. Removing this restriction would remove the need for the complex rules and both increase flexibility and meet the overall aim of simplifying tax legislation. As mentioned above, we do not believe this would come at a significant cost since the 50% restriction ensures that currently profitable companies all ought to, effectively, be paying a minimum tax regardless of the level of their loss carry forwards.

Detailed proposal for banks

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?

8. No comment

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

9. No comment

Detailed design points

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?

10. We believe the definition should follow the existing group relief definition.

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

11. We do not see the need for a new set of definitions for this purpose. This significantly adds to the complexity without there being an obvious significant issue with using the existing (and well understood) definition.

12. Further, although it is not covered in the consultation documents, we would note that we think companies should have the choice as to how they allocate the £5m threshold between group companies. The condoc covers the flexibility to choose what losses to allocate the £5m against but not the point about how the amount should first be allocated across the group.

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

13. We agree that the proposals outlined in paragraph 5.16 represent a practical way to bring the new reliefs within the consortium regime.

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

14. We agree with the comments in the consultation document that the existing anti-avoidance remains effective and we do not see the need for any changes here. Of the three avoidance issues noted in the document, the first 2 already exist with current law and the proposed changes would likely reduce any focus on this area. As to the third concern, as noted above, we believe there should not be a distinction drawn between pre and post April 2017 losses and such a change would also remove this concern.

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

15. Although we do not see any activity in this area, we can understand the concern and broadly keeping the existing anti-avoidance seems appropriate as the rules are well understood (at least in respect of the 'major change in the nature of the trade/business' test). However, we would ask that two changes be considered:

16. Consistent with the proposals to allow flexibility across loss pools, the restrictions for all types of losses could be brought into line so that only the 'major change in the nature' test applied and other tests (in particular, the 'significant increase in capital' test) be removed. In reality the 50% restriction is likely to act as a good deterrent against loss buying and this, together with the 'major change in the nature' test ought to provide sufficient protection to the Exchequer.

The 'significant increase in capital' test is out of date and unclear in its application which can lead to unnecessary concerns/complexity for some taxpayers.

17. The guidance on what is a major change in the nature of a trade was drafted many years ago and is of limited application to many businesses in the current day given all the digital changes etc. We would ask for this to be updated with some more current examples.

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?

18. No comment.

Other considerations

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

19. No comment.

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

20. No comment.

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

21. No comment.

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

22. No comment.

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

23. Start up companies would clearly be impacted and this change could impact whether some such companies end up being successful. We recommend that the rules do not apply to losses made in the first 5 years of business.

24. APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).