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# Finance Act 2015--avoidance using carried-forward losses

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**Tax analysis: Catherine Richardson, associate at Cadwalader, Wickersham & Taft LLP, examines the aspects of the Finance Act 2015 (FA 2015) which concern targeting avoidance using carried-forward losses.**

## What is the target for the new rule countering tax avoidance involving carried-forward losses?

Where losses for tax purposes arise within a company within a given year, such losses may be able to be offset against profits from other activities or surrendered to another company within the corporate group. When losses for tax purposes are not utilised in the year in which such losses arose, the ability of the company to utilise these losses going forward is generally restricted to the company and the activity in relation to which the losses arose. To this extent, the losses are 'carried forward'. As a result, current year losses are regarded as more flexible and valuable than carried-forward losses. Arrangements have therefore been devised which 'refresh' older carried-forward losses into newer, in-year losses.

FA 2015 introduces new rules (at FA 2015, s 33 and Sch 3) aimed at restricting the ability of companies to use tax-motivated arrangements to 'refresh' carried-forward losses.

These new rules are intended to target contrived arrangements rather than normal tax planning around mainly commercial transactions.

HMRC's Technical Note on the new rules, published on 18 March 2015, distinguishes between arrangements which utilise trapped losses by either shifting profits around the group or changing the timing of receipts and arrangements which go further by also creating a new in-year loss in the group such that the carried-forward loss is a new and more versatile loss. It is only this latter type of arrangement which is being targeted and, even then, only when it is reasonable to assume that the value of the tax advantage obtained will exceed any other economic benefits referable to the arrangement.

It is interesting to note that the use of arrangements to utilise 'trapped' non-trade deficits was expressly included in the general anti-abuse rule (GAAR) guidance as an example of a legitimate arrangement which would fall short of the reach of the GAAR.

## When did this rule come into effect?

Although FA 2015 received Royal Assent on 26 March 2015, the new rules preventing the refreshing of corporate losses applies for the purposes of calculating taxable profits of companies for accounting periods beginning on or after 18 March 2015 (being the date of the Chancellor of the Exchequer's Budget speech) but may apply in respect of arrangements entered into prior to this date.

Profits arising within an accounting period which straddles 18 March 2015 will be allocated to a notional period beginning on 18 March 2015, apportioned on a time basis or other just and reasonable basis.

## How hard do you think this rule will be for companies to monitor, given they need to consider what was 'reasonable to assume', whether securing a tax advantage was a

**main purpose and comparing the tax value of the arrangements against their non-tax value?**

The question of identifying whether the new rules will need to be considered in greater detail should be somewhat straightforward for companies to monitor as companies should be able to easily identify when carried forward losses exist and when consideration is being given as to how best to utilise such carried forward losses. At the same time, the relatively novel and highly subjective nature of the conditions to be satisfied has the potential to become a time consuming and complicated exercise. It is also worth noting that the 'reasonable to assume' test appears (albeit in a different context) in the new diverted profits tax legislation which was also enacted in FA 2015.

Some comfort may be able to be taken from the fact that the 'reasonable to assume' condition is determined at the time when the arrangement was entered into and accordingly should not require the company to continue to monitor the relative tax and non-tax values of the arrangements although determining the tax and non-tax values will present its own challenges.

## Could the impact of this rule be wider than anticipated?

Most definitely. The risk of the rules being wider than intended is likely to be a legitimate concern for corporation taxpayers and their advisers. While it is not the intention of the government that normal tax planning around commercial transactions should fall within the scope of the new rules, the broad terms in which the new rules are drafted and, specifically, the subjectivity deployed in the conditions (as noted above) has the potential to inadvertently capture legitimate tax planning and the utilisation of carried-forward losses.

The new rules will also likely impact upon distressed restructuring and reorganisation transactions where the utilisation of losses for tax purposes is a significant factor in commercial negotiations. The new rules will not only need to be considered by companies in the context of their own tax planning and structuring but also, for example, in the context of M&A tax indemnities in relation to the circumstances in which carried-forward losses have been utilised historically.

## If the rule applies, what happens to the carried-forward losses?

If all the necessary conditions for the carried-forward loss refresh prevention rules to apply are satisfied, the company to which the profits arose as a result of the arrangement will be denied a deduction against those profits for any amount in respect of the relevant carried-forward losses. It is significant that this is a denial of the deduction in whole rather than allowing any apportionment or deduction on a 'to the extent' basis but is arguably consistent with the policy intentions and motivations behind the new rules.

It is, though, worth noting that although the rules prevent a deduction against the relevant profits arising as a result of the arrangements, the carried-forward losses are not lost altogether and may still be available to be used in accordance with the normal rules for their use against profits not arising as a result of the arrangements.

## How do these rules interact with the new rules restricting carry-forward loss relief for banks?

FA 2015 also includes new rules which seek to restrict to 50% of taxable profits the extent to which carried-forward losses can be utilised by banks and building societies (FA 2015, s 32 and Sch 2). These restrictions on banks and building societies will take precedence over the restrictions on the refreshing of carried-forward losses for corporation tax purposes. This is the case as one of the tests to be satisfied in determining whether the offsetting of corporation tax carried-forward losses will be denied requires that the tax arrangements are not arrangements in respect of which a deduction would be denied by virtue of the limitation imposed on banks and building societies.

*Interviewed by Alex Heshmaty.*