



BUSINESS & PERSONAL TAX SUPPORT

Best Use of Tax Losses

Options for 2022/23



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If you have suffered losses, due to the Covid-19 pandemic or otherwise, you may be able to claim tax relief for those losses, and possibly generate a tax repayment in the process. The options for relieving losses will depend on whether you operate your business as an unincorporated business, or whether you operate through a limited company. You will also need to consider where you are in your company's lifecycle. If you are an unincorporated business, the available options will further depend on whether you use cash basis accounting.

When looking to optimise the relief for a loss, as a general rule you should try to obtain relief for the loss as early as possible and at the highest possible rate. You may need to choose which of these takes priority.

Unincorporated businesses

If you run an unincorporated business, for example, if you are a sole trader or a partner in a partnership, there are various ways in which you can obtain tax relief for a trading loss.

Option 1 – against general income of current and/or previous year

If you prepare your accounts using the accruals basis and realise a trading loss, you can claim relief against your total income of the year of the loss and/or the previous tax year. This is useful if you have other income. The claim can also be extended to capital gains in certain circumstances.

Where the loss is carried back and set against income of a previous year, this may trigger a repayment of tax already paid.

If, however, you prepare accounts using the cash basis, sideways loss relief (against other income) is not available, nor is relief against capital gains.

Claims cannot be tailored to preserve your personal allowance – the loss must be set in full against the income of the year for which relief is

claimed. This may result in your personal allowance being fully or partially lost.

Option 2 – extended carry-back for 2020/21 and 2021/22 losses

As a temporary measure, losses for 2020/21 and 2021/22 can be carried back and set against your trading profits for the previous three years. This option is available regardless of whether you prepare accounts under the accrual's basis or the cash basis.

If you use the accruals basis you have the option of sideways relief (as outlined in option 1 above) and cannot fully relieve a loss for 2020/21 under option 1 above, the extended carry-back rules allow you the additional option of carrying it back against trading profits of 2018/19 and 2017/18. Relief is given against the income of a later tax year first. Likewise, you can carry back a loss for 2021/22 which has not been fully utilised under option 1 above, against trading profits of 2019/20 and 2018/19. Where a claim has been made under option 1 above for any year, this takes precedence.

If, however, you use the cash basis to prepare your accounts, you can make use of the extended carry back rules to carry a trading loss back and set against trading profits from the previous three years, setting the loss against profits of a later year before an earlier year. The claim cannot be tailored to preserve personal allowances. If you use the cash basis and made a loss for 2020/21, you can set it against trading profits for 2019/20, 2018/19 and 2017/18. Where a loss is made for 2021/22, this can be set against any trading profits for 2020/21, 2019/20 and 2018/19.

Losses you can carry back under these rules are capped at £2 million a year.

Carrying the loss back may generate a welcome tax repayment.

We have used reasonable care and skill in assembling the information in this update. However, the information presented cannot be tailored to personal circumstances or particular situations. There may also be factors relevant to you which fall outside the scope of this publication. Accordingly, the material presented does not constitute personal or business advice. You should not rely solely on this update to make (or refrain from making) any decision or take (or refrain from taking) any action.

Option 3 – carry forward against future trading profits

Where you cannot relieve the loss under options 1 and 2 above (or option 4 below), you can carry the loss forward and set it against future profits of the same trade. You may prefer this option if carrying the loss back would result in the loss of your personal allowance.

In the absence of the extended carry back rules (outlined in option 2), if you use the cash basis and make a loss, you can only carry this loss forward against future profits of the same trade (unless the loss is a terminal loss: see option 5).

Option 4 – loss in the early years

If your business is new and you make a loss in the year in which start your trade or any of the following three years, you can set the loss of your net income of the three previous tax years, using the losses of the earliest year first. However, this option is not available if you prepare your accounts using the cash basis.

Option 5 – terminal loss

If you stop trading and you make a loss in the final 12 months of your trade, you can carry the loss back against the profits of the same trade for the period of the loss and the previous three tax years. This option is available regardless of whether you prepare your accounts using the accruals basis or the cash basis.

Losses cap

If you prepare your accounts under the accrual's basis, any losses that you relieve under options 1 (excluding any extension to capital gains) and 3 are subject to a cap of £50,000 or 25% of your net income if higher.

If you make a claim under the extended carry back rules, which are available for 2020/21 and 2021/22 losses (as outlined in option 3), the loss that can be relieved for each year under these rules is capped at £2 million.

Companies

If you run your business as a limited company, there are various options available for relieving the loss.

Carrying a loss back may generate a much-needed tax repayment.

Option 1 – against total profits of the same accounting period

You can relieve a trading loss in an accounting period against total profits, including chargeable gains, of the same accounting period. If you have made a trading loss as a result of the impact of COVID-19 or otherwise, but also realised chargeable gains in the same period, you can relieve the loss against those gains.

Option 2 – against profits of a preceding period

If you are unable to fully relieve a loss under option 1 above, you can carry the loss back against profits of the previous accounting period. This will generate a useful tax repayment and will often be preferable where this is an option rather than carrying the loss forward.

Option 3 – extended carry back

If you incurred losses in accounting periods ending between 1 April 2020 and 31 March 2020 you can benefit from an extended carry back period. You can carry the loss back (to the extent it cannot be relieved under option 1) against the profits of the same trade for the preceding three accounting periods. The loss is set against profits of a later year before an earlier year. Losses for an accounting period which can be carried back under these rules are capped at £2 million.

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Option 4 – carry forward against future profits

Losses can be carried forward and set against trading profits of the same trade. While the above options will normally be used in preference to carrying a loss forward, where your profits are in excess of £50,000, the rate at which you pay corporation tax will increase from 1 April 2023. Consequently, carrying the loss forward may provide relief at a higher rate, albeit later.

We can help

We can help you formulate a tax-efficient strategy for extracting profits from your personal or family company.

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