Corporate Capital Gains: Capital Losses after a Change of Ownership (Simplification)

Who is likely to be affected?
Groups of companies.

General description of the measure
Legislation will be introduced in Finance Bill 2011 to simplify rules for the treatment of capital losses after a company that is or has been a member of group changes ownership.

It will remove rules that restrict relief for certain capital losses realised after the change of ownership. It will maintain restrictions on relief for capital losses realised before the change of ownership.

Policy objective
This measure supports competitiveness and growth. It will make it easier for a group to integrate an acquired business into its existing operations without losing relief for any capital losses incurred by the acquired business. The changes are also intended to reduce the overlap with an anti-avoidance rule that prevents capital loss buying.

Background to this measure
- The previous government announced an intention to simplify some of the tax rules for related companies at the 2007 Pre-Budget Report.
- Business identified the rules on capital losses after a company changes ownership as a priority for reform. HM Revenue & Customs (HMRC) and HM Treasury met business and professional representatives regularly throughout 2008 and early 2009 to consider options for reform.
- A discussion document outlining proposals for the reform of three main areas, of which this is one, was issued by HMRC and HM Treasury on 17 June 2009.
- A consultation document with initial draft legislation for the lead proposals followed on 22 February 2010. Documents are available on the HM Treasury website.
- The draft legislation has been amended to take account of a number of points raised in consultation. A response to consultation was published on the 9 December 2010, alongside revised draft legislation.

Detailed proposal
Operative date
The measure will have effect in relation to the deduction of a pre-entry capital loss on and after the date that Finance Bill 2011 receives Royal Assent.
Current law

The loss-buying rules contained in Schedule 7A to the Taxation of Chargeable Gains Act 1992 (TCGA) restrict the use of capital losses when a company undergoes a change of ownership through a takeover or merger. Capital losses arising on the disposal of an asset the company had before the change can only be set against capital gains arising on pre-entry assets (i.e. those owned before the change by that company or its fellow group members), or on newly acquired assets that are used in a continuing trade of the company.

Consequently this streaming of losses can prevent a group obtaining full tax relief for capital losses even on disposals of assets years after a wholly commercial merger.

Proposed revisions

Changes will be made by Finance Bill 2011 to Schedule 7A to TCGA to remove its current restrictions on the use of capital losses realised after a change in ownership, made unnecessary by section 184A of TCGA.

A restriction will continue to apply to losses that have been realised before the company has a change of ownership, which can continue to be set against gains on pre-entry assets. However, such losses will also be allowable against any capital gains from assets that are used in the same business the company carried on before the change of ownership, removing the limitation that applied this rule only where the company carries on a trade. A wider reform removing these restrictions entirely would not have been affordable.

A further change removes the restriction on the use of losses unless the same company carries on the business after the change of ownership. It will be sufficient that the business continues somewhere within the new group.

Summary of impacts

<table>
<thead>
<tr>
<th>Exchequer impact (£m)</th>
<th>This measure is expected to reduce receipts by tens of millions a year over the scorecard period. The final costing will be subject to scrutiny by the Office for Budget Responsibility and will be set out at the Budget.</th>
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<tbody>
<tr>
<td>Economic impact</td>
<td>This measure is not expected to have significant economic impacts.</td>
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<tr>
<td>Impact on individuals and households</td>
<td>There is no direct impact on individuals and households as this measure concerns companies that are or were part of a group.</td>
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<tr>
<td>Equalities impacts</td>
<td>This is a corporation tax measure and is therefore unlikely to have any different impact on any equality group.</td>
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<tr>
<td>Impact on business including third sector</td>
<td>This measure is expected to benefit, on average, 5 to 10 large groups each year who are acquiring or merging with other groups or companies that have historic capital losses in their structure. The changes will allow earlier tax relief for some capital losses which a company realises after joining a new group, than was permitted under the previous rules. Under the new rules, it will also be easier for an acquired business to be integrated into the new owner’s group without losing relief for any acquired capital losses. The change will have a significant tax effect on some companies but the associated administrative or compliance cost will be negligible.</td>
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### Impact on public sector
There will be a negligible reduction in the costs to HMRC.

### Other impacts
The impact on small firms (with fewer than 20 employees) has been considered. However, this measure applies to groups of companies, and in practice is expected to benefit large corporate groups. It is unlikely that any firms with fewer than 20 employees will be affected. However, as this is a beneficial change, it would not be fair to exclude them.

### Monitoring and evaluation
The policy will be monitored through information collected from tax returns.

### Further advice
If you have any questions about this change, please contact Philip Donlan on 020 7147 2633 (email: philip.donlan@hmrc.gsi.gov.uk).
1 Chargeable gains: pre-entry losses

Schedule 1 contains provision about losses accruing to a company before the time when it becomes a member of a group of companies and losses accruing on assets held by any company at such a time.
SCHEDULE 1

CHARGEABLE GAINS: PRE-ENTRY LOSSES

TCGA 1992

1 In section 177A of TCGA 1992 (restriction on set-off of pre-entry losses), omit “and losses accruing on assets held by any company at such a time”.

2 Schedule 7A to that Act (restriction on set-off of pre-entry losses) is amended as follows.

3 (1) Paragraph 1 (application and construction of Schedule) is amended as follows.

   (2) In sub-paragraph (1) for “is or has been” substitute “becomes”.

   (3) For sub-paragraph (2) substitute—

       “(2) In this Schedule “pre-entry loss”, in relation to any company, means any allowable loss that accrued to that company at a time before it became a member of the relevant group.”

   (4) Omit sub-paragraphs (3), (3A), (4) and (5).

   (5) In sub-paragraph (6) for “Subject to” to “if” substitute “If”.

   (6) Omit sub-paragraph (8).

4 Omit paragraphs 2 to 5 (determination of pre-entry proportion of losses on pre-entry assets).

5 (1) Paragraph 6 (restrictions on the deduction of pre-entry losses) is amended as follows.

   (2) In sub-paragraph (2)—

       (a) omit paragraph (a) (and the “and” after it), and

       (b) in paragraph (b), omit “in any other case”.

   (3) In sub-paragraph (3)—

       (a) omit paragraph (a) (and the “and” after it), and

       (b) in paragraph (b), omit “in the case of an election under sub-paragraph (2)(b) above,”.

6 (1) Paragraph 7 (gains from which pre-entry losses are to be deductible) is amended as follows.

   (2) In sub-paragraph (1), for paragraph (c) substitute—

       “(c) on the disposal of any asset in respect of which the conditions in sub-paragraph (1A) are met.”

   (3) After that sub-paragraph insert—

       “(1A) The conditions referred to in sub-paragraph (1)(c) are—
(a) that the asset was acquired, on or after the entry date, by—

(i) the company to which the pre-entry loss accrued (“company A”), or

(ii) a company which, at the time of the acquisition, was a group company of company A, from a person who at the time of the acquisition was not a group company of company A, and

(b) that the asset has not, since its acquisition from that person, been used or held for any purposes other than those of a trade or business which—

(i) was being carried on by company A immediately before the entry date, and

(ii) continued until the disposal to be carried on by company A or a company which, when it carried on the trade or business, was a group company of company A.

(1B) For the purposes of sub-paragraph (1A), a company is a “group company of company A” at any time when it is a member of a group of companies of which company A is also a member.

(1C) Where a company, having become a member of the relevant group, subsequently becomes a member of another group (“the new group”)—

(a) sub-paragraph (1) continues to have effect, in relation to any loss which accrued to the company before it became a member of the relevant group, by reference to the date on which it became such a member, and

(b) accordingly, that sub-paragraph does not apply separately in relation to the loss by reason of it also having accrued to the company before it became a member of the new group.”

(4) Omit sub-paragraph (2),

(5) In sub-paragraph (3)—

(a) omit “, without prejudice to paragraph 9 below”,

(b) omit paragraph (b), and

(c) in paragraph (c), “for sub-paragraphs (1)(c) and (2)(c)” substitute “sub-paragraph (1A)”.

(6) For sub-paragraph (4) substitute—

“(4) Sub-paragraphs (4A) and (4B) apply for determining for the purposes of this paragraph whether an asset on the disposal of which a chargeable gain accrues was an asset held by a company immediately before the entry date (a “pre-entry asset”).

(4A) Except as provided by subsection (4B), an asset is not a pre-entry asset if—

(a) the company which held the asset at the entry date is not the company which makes the disposal, and

(b) since the entry date that asset has been disposed of otherwise than by a disposal to which section 171 applies.
(4B) Without prejudice to sub-paragraph (4C), where, on a disposal to which section 171 does not apply—
   (a) an asset would cease to be a pre-entry asset by virtue of sub-paragraph (4A), but
   (b) the company making the disposal retains an interest in or over the asset in question,
that interest is a pre-entry asset.

(4C) For the purposes of this paragraph—
   (a) an asset acquired or held by a company at any time and an asset held at a later time by that company, or by any company which is or has been a member of the same group of companies as that company, is to be treated as the same asset if the value of the second asset is derived in whole or in part from the first asset, and
   (b) if—
      (i) any asset is treated (whether by virtue of paragraph (a) or otherwise) as the same as an asset held by a company at a later time, and
      (ii) the first asset would have been a pre-entry asset in relation to that company,
the second asset is also to be treated as a pre-entry asset in relation to that company;
and paragraph (a) applies, in particular, where the second asset is a freehold and the first asset is a leasehold the lessee of which acquires the reversion."

(7) In sub-paragraph (5) omit “or (2)” (in both places).

(8) In sub-paragraph (6) omit “or (2)”.

7 (1) Paragraph 8 (change of a company’s nature) is amended as follows.

(2) In sub-paragraph (1)—
   (a) in paragraph (a) for “carried on by that company” substitute “which was carried on by that company immediately before it became a member of that group”,
   (b) after “trade” (in each place) insert “or business”, and
   (c) for “paragraph 7(1)(c) and (2)(c)” substitute “paragraph 7(1A)”.

(3) For sub-paragraph (2) substitute—

“(2) In sub-paragraph (1) “a major change in the nature or conduct of a trade or business” includes—
   (a) a major change in the type of property dealt in, or services or facilities provided, in the trade or business,
   (b) a major change in customers, markets or outlets of the trade or business, or
   (c) in the case of a company with investment business (within the meaning of section 1218 of CTA 2009), a major change in the nature of the investments held;
and this paragraph applies even if the change is the result of a gradual process which began outside the period of three years mentioned in sub-paragraph (1)(a).”
8. Omit paragraph 9 (identification of “the relevant group” and application of Schedule to every connected group).

9. In paragraph 11 (continuity provisions), omit sub-paragraph (3)(b) (and the “and” before it).

Consequential provision

10. Omit the following provisions (which relate to the provisions repealed by paragraphs 1 to 9)—
   (a) in FA 1994, sections 93(8) to (10) and 94;
   (b) in FA 1998, section 138;
   (c) in FA 2000, in Schedule 29, paragraph 7(2) to (5);
   (d) in F(No 2)A 2005, section 65(2), (3) and (5).

Commencement

11. (1) The amendments made by this Part of this Schedule have effect on and after commencement in relation to the deduction of any pre-entry loss within paragraph 1(2)(a) of Schedule 7A to TCGA 1992 (as amended by this Part) regardless of—
   (a) whether the loss accrued before or on or after commencement, and
   (b) whether the company which accrued the loss became a member of the relevant group (within the meaning of that Schedule) before or on or after commencement.

   (2) In this paragraph “commencement” means the day on which this Act is passed.

Transitional provision

12. (1) Sub-paragraph (2) applies where, immediately before commencement, Schedule 7A to TCGA 1992 had effect, in the case of a company which is or has been a member of a group of companies (“the relevant group”) in relation to a loss of that company within paragraph 1(2)(b) of that Schedule (pre-entry proportion of an allowable loss that has accrued to a company on the disposal of a pre-entry asset).

   (2) On and after commencement that loss is to be treated, for the purposes of Schedule 7A to TCGA 1992, as if it were a pre-entry loss within the meaning of paragraph 1(2) of that Schedule (as substituted by paragraph 3 of this Schedule) which accrued to that company immediately before it became a member of the relevant group.

   (3) In this paragraph “commencement” means the day on which this Act is passed.
DRAFT EXPLANATORY NOTE

CHARGEABLE GAINS: PRE-ENTRY LOSSES

SUMMARY

1. This clause and Schedule simplify the current rules that apply to restrict the circumstances in which capital losses of a company that joins a group can be set against gains. In particular, the use of losses that arise after a company joins a group will no longer be restricted. Losses that are restricted may be used against gains arising on assets used in the same business that the company conducted before joining the group rather than, as now, only against gains on assets used in the same trade.

DETAILS OF THE SCHEDULE

2. Paragraph 3 amends the definition of a “pre-entry loss” for the purposes of Schedule 7A to the Taxation of Chargeable Gains Act 1992 (TCGA) so that it only applies to the losses of a company that accrue before it becomes a member of a group.

3. Paragraphs 3 and 4 remove from Schedule 7A all of those parts that restrict the capital losses of a company that accrue after it becomes a member of a group.

4. Paragraph 5 amends paragraph 6(2) of Schedule 7A. This provides a procedure by which, in certain circumstances, a company can elect whether it is restricted “pre-entry losses” or other losses have been allowed against gains. The change reflects the more limited circumstances in which a loss may be restricted.

5. Paragraph 6(2) and (3) extend the circumstances in which a restricted loss may be used to include setting off against gains arising on assets used in any trade or business that was carried on by the company before it joined the group. After the company joins the group, it is not necessary that the trade or business continues to be carried on by that company; it may be carried on by any company within the same group as the company that incurred the loss. A new paragraph 7(1A) is inserted into Schedule 7A that sets out the conditions to be met. New paragraph 7(1B) provides a definition of “group company” for this purpose.

6. Paragraph 6(3) also inserts into Schedule 7A a new paragraph 7(1C) which sets out clearly the rule that once a loss has become subject to restriction under the Schedule then the same restriction continues to apply should the company subsequently join another group.
7. **Paragraph 6(6)** amends paragraph 7 of Schedule 7A to set out a definition of “pre-entry asset”, the gains on which may be have restricted losses deducted. The definition previously depended on the rules for restricting losses that accrue after the company join the group, which have been repealed.

8. **Paragraph 7** amends paragraph 8 of Schedule 7A which applies to the use of restricted losses where there has been a major change in the activity of a company after it joins a group. The changes take account of the extension of the use of restricted losses to gains on assets used for a continuing business, rather than just a continuing trade.

9. **Paragraph 11** sets out the commencement provision. The new rules apply to the deduction on or after the day that the Finance Bill receives Royal Assent of any loss that has accrued before a company joined a group.

10. **Paragraph 12** is a transitional provision. Where a loss on the disposal of an asset after a company joined a group is subject to restriction under the current rule, then it will be treated as one that arose before the company joined the group for the purposes of the amended rules.

**BACKGROUND NOTE**

11. The changes introduced by this clause follow extensive consultation by HM Treasury and HM Revenue & Customs aimed at simplifying the group aspects of the corporation tax chargeable gains regime.

12. The revisions to Schedule 7A to TCGA will reduce compliance costs by simplifying the rules that apply to restrict the use of losses when a company joins a group.

13. The amended rules will apply a restriction only to losses that have been realised before the company joins the group and will also allow restricted losses to be used against gains in a continuing business rather than only against those in a continuing trade.

14. The existing scope of the restrictions is no longer required because the tax motivated acquisition of companies with losses is addressed by a targeted anti-avoidance rule at section 184A of TCGA.

15. If you have any questions about this change or comments on the legislation, please contact Philip Donlan on 020 7147 2633 (email: philip.donlan@hmrc.gsi.gov.uk) or Dipti Shah on 020 7147 2349 (email: dipti.shah1@hmrc.gsi.gov.uk).