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Category	**Course title**	**Author**
Tax	Income tax losses (1)	Cath Hall

Content Table

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Income tax losses (1)

1. Introduction

These income tax loss relief modules, in two parts, examine the relief available to sole traders for income tax losses incurred as part of their trade. The main loss reliefs are described in this first module.

The restrictions with regard to trading losses are described in the second module.

2. Calculation and use of trading losses

Trading losses (and property losses) are generally computed according to the same rules used to compute trading profits i.e. in accordance with GAAP or on the cash basis.

The main reliefs that may be obtained for trading losses are as follows:

1. Set-off against income of the same tax year or preceding year;
2. Set-off against capital gains of the same tax year or preceding tax year (if, and to the extent that, the loss remains unrelieved after applying 1 above);
3. Carry-back of losses in the opening years of a trade;
4. Carry-back of terminal losses in the closing years of a trade; and
5. Carry-forward against subsequent profits of the same trade.

The first three reliefs are often referred to as 'sideways relief'.

Where a loss can be relieved under more than one provision and it is sufficiently large, the taxpayer can select the order in which the different provisions are to be applied, but the whole of the income or profits available for relief under one provision must be relieved before going onto the next provision (*Butt v Haxby Ch D 1982 56TC547)*.

3. Set-off of trading losses against other income

Where in any tax year a person sustains a loss in a trade, profession or vocation, carried on solely or in partnership, he may make a claim on or before the first anniversary of 31st January following that tax year for relief against other income of:

(i) the tax year in which the loss is incurred; or
(ii) the tax year preceding that in which the loss is incurred; or
(iii) both those tax years.

A person sustains a trading loss in a tax year when he sustains a loss in the basis period for that tax year.

A claim within (i) above is made under s64 (2)(a) ITA 2007.

A claim within (ii) above is made under s64(2)(b) ITA 2007.

A claim within (iii) above is made under s64 (2)(c) ITA 2007.

If a claim is made within (i) above and the loss is not wholly exhausted, a subsequent claim can be made (within the time limit) within (ii) above, and vice versa.

A claim operates by deducting the loss in arriving at net income for the relevant tax year.

There is a cap for 2013/14 onwards (subject to transitional rules for losses carried back), on the total amount of prescribed Income Tax reliefs that individuals can claim. These are covered in the second module.

Where a claim is made for a loss to be set against the income of both the same tax year and the preceding tax year, there is no statutory order of priority. The claimant must specify the tax year for which the deduction from income should be made first.

Where claims are made, against income of the same year, both under (i) above in respect of that year's loss and under (ii) above in respect of the following year's loss, (i) takes priority.

Note that no relief under this provision is available where a cash basis election is in force.

The income against which a loss is set is income *before* deduction of the personal allowance. The allowances will therefore be wasted if the income of a particular tax year is fully covered by a loss claim.

The effect on personal allowances, rates of tax etc. needs to be carefully considered.

Partial claims against one year's income are not permitted. If a loss is set against income of a particular tax year, it must be fully set against that income until either the loss or the available income is exhausted.

Example 1

Jay prepares accounts to 30 April each year and the loss for the year ended 30 April 2018 is £40,000.

The loss for 2018/19 is therefore £40,000.

A loss relief claim against other income may be made in:
- 2018/19, and/or
- 2017/18

If a claim is made in both years, they can be made in any order but cannot be restricted to preserve the personal allowance.

4. Set-off of trading losses against capital gains

Where relief is available under s64 ITA 2007 above for a tax year and either a claim is made under that section or the person's total income for the year is either nil or does not include any income from which the loss can be deducted, a claim may also

be made under s261B Taxation of Chargeable Gains Act (TCGA) 1992 for the determination of the 'relevant amount'.

This is so much of the trading loss as:

a) is not deducted in calculating the claimant's net income for the year of claim; and
b) has not already been relieved for any other year.

The claim is not deemed to be determined until the relevant amount for the year can no longer be varied, whether by the Tribunal on appeal or on the order of any court.

The relevant amount is treated for the purposes of Capital Gains Tax as an allowable loss accruing to the claimant in the tax year, except that it cannot exceed the 'maximum amount'. Any such excess remains an Income Tax loss.

The 'maximum amount' for this purpose is the amount on which the claimant would be chargeable to Capital Gains Tax for that year, disregarding this provision and the Capital Gains Tax annual exempt amount.

No amount treated in these circumstances as an allowable loss may be deducted from chargeable gains accruing in a tax year which begins after the claimant has ceased to carry on the trade in which the loss was sustained.

A claim must be made on or before the first anniversary of the normal self-assessment filing date for the tax year in which the loss was made.

Note that no relief is available under this provision where a cash basis election is in force.

5. Losses in the opening years of trade

If an individual sustains a loss in a trade, profession or vocation in any of the first four tax years in which the trade etc., is first carried on by him, he may claim relief for that loss against his other income of the *three* tax years preceding the year of loss.

Income of earlier years is relieved in priority to that of later years.

The trade must have been carried on during the 'period of loss' on a commercial basis with a reasonable expectation of profits during that period or within a reasonable time afterwards. This is an objective test (*Walls v Livesey (Sp C 4))*. The 'period of loss' is the basis period in which the loss is sustained.

The relief is available to an individual sole trader or an individual in partnership by reference to the first four tax years in which he is a partner.

Note that no relief is available where a cash basis election is in force.

There is a cap for 2013/14 onwards (subject to transitional rules for losses carried back), on the total amount of prescribed Income Tax reliefs that individuals can claim. These are covered in the next module.

A claim is made under s72 ITA 2007.

The claim operates by deducting the loss in arriving at net income for the earliest of the three years preceding the year of loss, then (assuming there is any unrelieved balance) the year after that and finally the latest of the three tax years. Any amount still unrelieved is potentially available for relief under any of the other trading loss reliefs.

Claims must be made on or before the first anniversary of 31st January following the tax year in which the loss is sustained.

The income against which a loss is set is income before deduction of the personal allowance. Note the previous comments re wasted loss relief.

Partial claims are not permitted – Note previous comments. It is not possible to claim to carry back a loss under these provisions against the income of one or two specified years as opposed to all of the three years in question.

Example 2

Henri started trading on 1 January 2018 and prepared accounts to 5 April each year.

Using the CYB opening year rules he has a trading loss for 2017/18 of £18,000.
The loss for 2017/18 may be the subject of a claim against total income of 2017/18 and/or 2016/17.

Under the opening year loss relief rules the loss of 2017/18 may be carried back against general income of 2014/15, 2015/16 and 2016/17 in that order.

The relief may not be restricted to preserve the personal allowance and the loss must be utilised in full against each year in turn until exhausted.

6. Terminal loss relief

If an individual ceases to carry on a trade or profession in a tax year and makes terminal losses, a claim may be made under s89 ITA 2007 to set off the total amount of terminal losses against the profits of the trade for the tax year of cessation and the three preceding tax years.

The terminal loss is essentially the loss of the last 12 months of trading, but computed as described below.

The claim operates by deducting this amount in computing the net income for those tax years with the deduction of the terminal loss for each year restricted to the *trading profits* available.

The deduction must be made first for the latest tax year in which there are available profits. If those profits are insufficient, the deduction must be made for the previous year, and so on until either the total amount of the terminal losses or the maximum three-year carry-back period is spent. Any amount unrelieved is potentially available for relief under any of the other trading loss reliefs (subject to the conditions and time limits for claiming those reliefs).

Subject to the maximum three-year carry-back period, terminal losses must be deducted from available profits even if those profits might otherwise have been covered by personal reliefs. Partial deductions are not permitted.

The terminal loss comprises:

a) the loss (if any) sustained in the final tax year (i.e. the period from 6th April to cessation); and
b) the loss (if any) sustained in that part of the penultimate tax year that falls within the twelve months immediately preceding cessation;

to the extent that such losses have not been relieved under another provision.

A terminal relief claim must cover both the loss (if any) at (a) and the loss (if any) at (b). It is not possible to include one and not the other. If there is an overall profit at (a) but a loss at (b), or the other way round, the profit is not netted off against the loss but will be disregarded.

If periods of account do not coincide with tax years, time apportionment must be used to calculate the figures at (a) and (b).

A claim for relief must be made within four years after the end of the tax year in which cessation occurs.

Terminal loss relief is available to an outgoing member of a partnership in respect of losses sustained in his notional trade. All partners may claim terminal loss relief on cessation of the actual partnership's trade.

Overlap relief is a deduction in computing the profit or loss of the final tax year (not the final period of account). It will therefore be included in full in a terminal loss claim.

Example 3

Nish ceased trading on 30 June 2018. Results are as follows:

Year ended 31 December 2017: Profit	£24,000
Six months ended 30 June 2018: Loss	£(9,000)
Overlap profit on commencement:	£3,000

Nish's terminal loss is calculated as:

	£
(a) 6.4.2018 – 30.6.2018	
3/6 x £(9,000)	(4,500)
(b) 1.7.2017 – 5.4.2018	
6/12 x £24,000 + 3/6x £(9,000)	nil
(c) Overlap profit	(3,000)
Terminal loss	(7,500)

7. Treatment of trading losses carried forward

On a claim under s83 ITA 2007, any trading loss not used as above (or any unused balance) may be carried forward to subsequent years without time limit.

A claim operates by deducting the loss in arriving at net income for subsequent tax years. The losses carried forward can only be deducted from profits of the same trade, profession or vocation carried on by the same individual.

The deduction must be made from the first available profits (and then, if those profits are insufficient, from the next available, and so on until the loss is exhausted). The deduction is made in priority to any other deductions from available profits. The loss must be deducted from available profits even if those profits might otherwise have been covered by personal reliefs. Partial deductions are not permitted.

A claim to carry forward a loss must be made within four years after the end of the tax year in which the loss arose. The loss is relieved automatically against subsequent profits with no further claim being necessary.