CHAPTER 17

LOSSES – OPENING AND CLOSING YEAR RULES

Statutory references are to ITA 2007 unless stated otherwise

17.1 Opening year losses

In the opening years of a trade, a special loss relief is available known as early trade losses relief. This applies to all losses sustained in the **first 4 tax years of trading**. If a trade commences on 1 January 2011 (i.e. in the tax year 2010/11) the special loss relief will be available in respect of losses sustained in the tax years 2010/11, 2011/12, 2012/13 and 2013/14. These rules are contained in sections 72-74 ITA 2007.

17.2 Overlap losses

Where a trader chooses a year end other than 5 April (or 31 March), overlap profit arises under the CYB opening year rules. Overlap profit is profit which is taxed twice. However, HMRC does not permit double-counting of losses. Consequently there is no such thing as an "overlap loss". Therefore where the basis periods overlap, a **loss must be recognised only in the earlier of the two periods**. ITTOIA 2005, s. 206

Illustration 1

A trade commences on 1 January 2011 and a loss arises in the year ended 31 December 2011 of £(24,000). The basis period for year 1 is as follows:

2010/11

1 January 2011 – 5 April 2011

Loss: $\frac{3}{12}$ x (£24,000) £(6,000)

Looking at Year 2 (2011/12), the basis period will be the 12 months to 31 December 2011 which shows a loss of £24,000. However, as we recognised £6,000 of that loss in the previous tax year, we must reduce the loss available in the later year.

2011/12	
Y/e 31 December 2011	£
Loss	(24,000)
Loss already recognised in 2010/11	6,000
Loss of 2011/12	£(18,000)

17.3 The effect of an early trade loss relief claim

Early trade loss relief **carries a loss back against net income of the 3 preceding tax years,** taking the **earlier years first**. Assume in 2010/11 a trader has a loss. The years that he can carry the loss back to are 2009/10, 2008/09 and 2007/08. The loss is **firstly** carried back to 2007/08, the earlier of the 3 years. **Then** it is utilised in 2008/09 and finally in 2009/10. ITA 2007, s. 72-s.74

Illustration 2

Consider a taxpayer with a loss of £25,000 in 2010/11 and net income in each of the 3 previous years of £10,000. The claim is **all or nothing for all 3 years combined.** Therefore once a claim has been made, we must either wipe out all of the available net income for all of the 3 previous years or utilise all of the loss. The effect of the claim will be as follows:

	2007/08	*2008/09*	*2009/10*	*2010/11*
	£	£	£	
Net Income	10,000	10,000	10,000	
Trading loss				(25,000)
Early trade loss relief	(10,000)	(10,000)	(5,000)	

A **claim** under s.72 ITA 2007 must be made **by 31 January, 22 months following the end** of the tax year of the loss. For example, for a loss in the tax year 2010/11 a claim should be made by 31 January 2013.

This is the same time limit as applies in respect of s.64 losses. Unfortunately there is **no s.71/s.261B TCGA 1992 equivalent claim in respect of s.72** and consequently no extension can be made in respect of capital gains for those years.

17.4 Closing Year Losses

ITA 2007, s. 89 - 94

When a trader ceases trading, **terminal loss relief** is available under s.89. This allows a loss to be deducted from trading profits in the tax year of cessation and to be **carried back to the 3 preceding tax years**, taking **later years first**. ITA 2007, s. 91 The losses are set against profits of the trade. It is **not** a net income claim - relief is **only against trading income.**

17.5 Computing a terminal loss

When computing the terminal loss, the terminal loss period is usually the **final 12 months of trading**. This is not necessarily the same as the loss in the final accounting period, because cessation accounts are rarely exactly 12 months long. As we shall see in the illustration which follows, we calculate the terminal loss on a **tax year basis**. ITA 2007, s. 90

Illustration 3

A trader has been drawing accounts to 31 December. He ceases trading on 30 June 2010 and draws a 6-month set of accounts to that date. The accounts to December 2009 show a tax adjusted profit, while the cessation accounts to June 2010 show a loss.

The terminal loss, which we can carry back 3 years, is the **loss arising in the final 12 months of trade** – ie from 1 July 2009 to 30 June 2010. To calculate this loss, we **split the 12-month period either side of 6 April 2010.** First we work out the loss in the **final tax year 2010/11** – i.e. between 6 April 2010 and 30 June 2010. We then **add on** any losses in the **preceding tax year** – ie, losses arising between 1 July 2009 and 5 April 2010. We add these together to give us the **terminal loss**.

ITA 2007, s. 90 (1)

Final tax year	
6 April 2010 – 30 June 2010	(X)
Preceding tax year	
1 July 2009 – 5 April 2010	(X)
Loss of final twelve months	(X)

If there is **no loss** in the preceding tax year – for example if the results for the period 1 July 2009 to 5 April 2010 give a **profit** – this **profit can be ignored**.

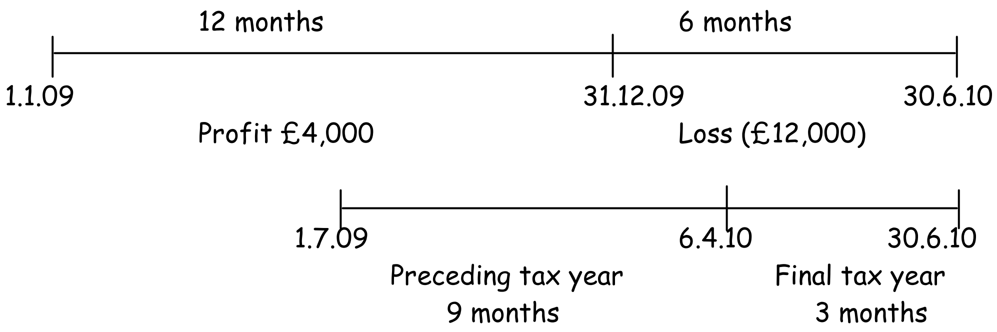
The terminal loss will also include the **relief for overlap profits brought forward.** Overlap profits are deducted from any profits in the **final tax year** of trade. By the same principle, any overlap profits will **increase a terminal loss**. Therefore having calculated overlap profits, they are **added** to any losses arising in the final tax year. ITA 2007, s. 90(5)

Loss of final tax year	
6 April to cessation	(X)
Add: Overlap profits b/f to loss	(X)
	(X)
Loss of preceding tax year	
12 months before cessation to 5 April	(X)
Terminal loss	(X)

Illustration 4

Continuing Illustration 3, a trader with a 31 December year end ceased trading on 30 June 2010. The year to December 2009 shows a profit of £4,000. The results for the period to 30 June 2010 are a loss of £12,000. Assume the **overlap** relief is £3,000. This will either be **real** overlap relief that arose on the commencement of trade or **transitional** overlap relief.

Our requirement here is to first **calculate** the terminal loss, and then to show how the loss is **offset** against trading income of previous years.



2010/11	
Loss of final tax year	£
6 April 2010 – 30 June 2010	
$\frac{3}{6}$ x (12,000)	(6,000)
Add: Overlap profits to loss	(3,000)
Loss of final tax year	£(9,000)

Terminal losses are calculated on a **tax year** basis. The tax year of cessation is 2010/11, so we first work out the loss arising in this **final year**. The loss in 2010/11 is the loss arising between **6 April** 2010 and **30 June** 2010. Accounts for the 6 months ended 30 June 2010 show a loss of £12,000. The loss in 2010/11 is therefore **three sixths** of this loss being £6,000.

Overlap profits of £3,000 increase this loss. The loss in 2010/11 is therefore £9,000.

The next step is to work out the loss arising in 2009/10.

The loss of 2010/11 is £9,000 and covers a **3 month** period. We now need to calculate any losses arising in the **9 months** before April 2010 – i.e. between 1 July 2009 and 5 April 2010. Remember that terminal losses are losses arising in the final **12 months** of trade.

2009/10	
Loss of preceding tax year	£
1 July 2009 – 5 April 2010	
1 January 2010 – 5 April 2010	
$\frac{3}{6} \times (12{,}000)$	(6,000)
1 July 2009 – 31 December 2009	
$\frac{6}{12} \times 4{,}000$	2,000
	(4,000)

First consider the period from 1 January 2010 to 5 April 2010. Losses in this period are £6,000 – ie 3/6th of the loss of the final 6 months of trade. Next we look at losses in the 6 months before that – ie from 1 July to 31 December 2009. The results for the **12 months** to December 2009 show a **profit** of £4,000. Profits for 6 months of this period are therefore **£2,000**.

Having offset profits and losses in this 9-month period, we are left with a **loss** of £4,000. If the figures had produced a **profit** in 2009/10, this profit would be **ignored** – it would **not** decrease the terminal loss.

The terminal loss is therefore:

£(9,000) + £(4,000) £(13,000)

It is this figure which we are allowed to offset against trade profits in the final tax year and then carry back and set against Trading Profits in the preceding 3 years. We will **allocate** the terminal loss of £13,000 looking at the final year and the **3 years preceding the year of cessation on a "last-in-first-out" basis.** ITA 2007, s. 91

There are trading profits of Nil in the final year (2010/11) so we will consider the prior 3 years. Here we would relieve the loss first in 2009/10, then in 2008/09 and finally in 2007/08. Any unrelieved terminal losses at that point will be wasted.

The trading income for the final 4 years is as follows:

	2007/08	*2008/09*	*2009/10*	*2010/11*
	£	£	£	£
Trading Income	10,000	6,000	4,000	Nil

Note that where a period has a **loss** – i.e. 2010/11 – the trading income is entered as **zero**. Terminal losses will be **set against** trading income.

As there is no trading income in 2010/11, there are no losses to offset.

In 2009/10 we offset **£4,000** of the terminal loss. In 2008/09 we use **£6,000** of the terminal loss. We now have **£3,000** of the terminal loss remaining. This can be used in 2007/08. Trading income in this year is now £7,000.

As tax would already have been paid on the **original** profits, the effect of a terminal losses claim will be to **generate repayments for these 3 tax years**.

	2007/08	*2008/09*	*2009/10*	*2010/11*
	£	£	£	£
Trading Income	10,000	6,000	4,000	Nil
Terminal loss relief	**(3,000)**	**(6,000)**	**(4,000)**	—
Revised Trading Income	£7,000	Nil	Nil	Nil

Actual trading loss of final tax year of trade

The actual trading loss allocated to the final tax year of trade will be the same as the terminal loss only where the final accounting period of trade is exactly 12 months long. Otherwise, **the terminal loss and the actual trading loss of the final tax year will be different.**

In the previous illustration our trader had the following tax adjusted figures for the final two accounting periods of trade:

	£
y/e 31 December 2009	4,000 profit
6 m/e 30 June 2010	(12,000) loss

and unrelieved overlap profits were £3,000.

Using the normal closing year rules, the trading loss of the final tax year of trade is:

2010/11	£
6 m/e 30 June 2010	(12,000)
Add: overlap profits to loss	(3,000)
Trading loss	**(15,000)**

Therefore the trader can actually claim relief for £15,000 of loss relating to 2010/11 using a s.64 claim against net income or a s.71 claim to convert some of the trading loss into a capital loss (after a s.64 claim has been made in that tax year).

However, as we have just calculated, **only £13,000 of this trading loss** is deemed to be a **terminal loss** which can be used against the trading profits of the final tax year of trade and then carried back against the trading profits of the 3 preceding tax years.

It is up to the trader which loss reliefs he claims. If he decides to make **both a s.64 ITA 2007 claim and a terminal loss relief claim**, then he **can do the claims in any order**. The only restriction is that he can not use more than £13,000 of the loss as a terminal loss.

17.6 Losses remaining at incorporation

ITA 2007, s. 86

Consider an individual (Chris) who sets up a company called Jones Ltd. If Chris transfers the trade into Jones Ltd (he incorporates his business) the **losses do not get transferred to the company** - **the losses belong to Chris**.

The transfer of the trade into the company will mean that Chris has ceased to trade and as a result losses cannot be carried forward under s.83 - profits can only be carried forward and set against future profits of the **same trade.** As Chris no longer carries on the trade, s.83 relief is not available. So what happens to these losses?

The trade is now in Jones Ltd. Chris now works for Jones Ltd and is likely to have shares in that company. Chris will obtain his remuneration from Jones Ltd in the form of a salary and/or dividends.

Where the trade in which the loss was incurred is transferred to a company, the loss can be carried forward and deducted from the individual's income derived from that company. Therefore under s.86 Chris may **set these losses against the salary and dividends** he receives from Jones Ltd.

S.86 may be claimed provided that:

- the business was transferred to a company and the consideration paid was "solely or mainly" in shares. "Mainly" in this context is taken to be at least 80% of the consideration received was in shares; and

- the shareholder still owns the shares throughout the whole of the tax year in which the loss relief is claimed.

Example 1

Jonathan commenced trading on 1 December 2010. He draws accounts to 31 December. In his first accounting period ended on 31 December 2011, Jonathan made a loss of £104,000. Prior to commencing to trade, Jonathan was employed earning a salary of £1,500 per month. He has no other income.

Show how Jonathan's loss will be relieved under s.72 ITA 2007.

Example 2

Miranda ceased trading on 31 July 2010. She had been trading for many years. Recent accounts show the following:

Y/e 31.12.09	£18,000 profit
7m/e 31.7.10	£(14,000) loss

Overlap profits being carried forward were £3,000.

Calculate Miranda's terminal loss.

Answer 1

Jonathan starts trading in 2010/11. Under the CYB opening year rules his basis period will be as follows:

Year 1 (2010/11)

1.12.10 – 5.4.11

Loss: $\frac{4}{13} \times £(104{,}000)$ = £(32,000)

This loss will be carried back to the 3 earlier tax years. In 2007/08 Jonathan had net income of £18,000 based on his salary of £1,500 per month. He also had the same net income in 2008/2009 and 2009/2010.

The loss must go back to the **earlier** of the 3 preceding tax years. This will reduce the 2007/08 income by £18,000. The loss will then go automatically to the following tax year (2008/09). As there are £14,000 of the £32,000 losses left, these will reduce 2008/09 income. The total loss of 2010/11 that will be relieved under s.72 will therefore be £32,000.

	2007/08	*2008/09*	*2009/10*	*2010/11*
	£	£	£	
Net Income	18,000	18,000	18,000	
Loss				(32,000)
Early trade loss relief	(18,000)	(14,000)		

Year 2 (2011/12)

Basis period is the 12 months up to the accounts date

1.1.11 – 31.12.11

Loss: $\frac{12}{13} \times £(104{,}000)$ = £(96,000)

However, some of this loss (1.1.11 – 5.4.11 = 3 months) has been allocated to 2010/11. As there is no overlap of losses, these losses cannot be counted again in 2011/12.

2011/12	
Y/e 31 December 2011	£
Loss	(96,000)
Loss already recognised in 2010/11	
3/13 x £(104,000)	24,000
Loss of 2011/12	£(72,000)

This 2011/12 loss of £72,000 will be carried back to the 3 earlier tax years.

In 2008/09 Jonathan originally had net income of £18,000. This has been reduced by a carry back claim under s.72 for 2010/11 (see above). The revised net income is now £4,000. Even though this is below the personal allowance for the year, if Jonathan wishes to make a s.72 claim for 2011/12, he must start by wiping out the net income of 2008/09. He has no choice. This will waste the personal allowance for 2008/09.

He has net income of £18,000 in 2009/2010 and £12,000 (i.e. £1,500 x 8 months because he was employed between April and November 2010) in 2010/11.

The loss must go back to the **earliest** of the 3 preceding tax years. This will reduce the 2008/09 income to nil. The loss will then go automatically to the following tax year, 2009/10, again reducing net income to nil. The same will happen in 2010/11.

	2007/08	*2008/09*	*2009/10*	*2010/11*	*2011/12*
	£	£	£	£	£
Net Income	Nil	4,000	18,000	12,000	
Loss					(72,000)
Early trade loss relief		(4,000)	(18,000)	(12,000)	

The loss remaining after the s.72 claim is:

	£
Loss of 2011/12	(72,000)
Loss used in:	
2008/09	4,000
2009/10	18,000
2010/11	12,000
Loss remaining	(38,000)

This loss will be carried forward against future trading profits under s.83.

Answer 2

Miranda's terminal loss will be the loss arising in the final **12 months** of trade.

First we work out the loss arising in the final tax year, 2010/11. We therefore calculate losses in the **4-month** period from 6 April 2010 to 31 July 2010.

Next we work out losses for 2009/10. This will be for the **8-month** period from 1 August 2009 to 5 April 2010. We add these together to form the terminal loss.

12 months | 7 months

1.1.09 | 31.12.09 | 31.7.10

Profit £18,000 | Loss (£14,000)

1.8.09 | 6.4.10 | 31.7.10

Preceding tax year 8 months | Final tax year 4 months

2010/11			£
6.4.10 – 31.7.10	Loss $\frac{4}{7}$ x £(14,000)		(8,000)
Add: Overlap profits to loss			(3,000)
			(11,000)
2009/10			
1.8.09 – 5.4.10			
1.1.10 – 5.4.10	Loss: $\frac{3}{7}$ x (14,000)	(6,000)	
1.8.09 – 31.12.09	Profit $\frac{5}{12}$ x 18,000	7,500	
Profit		1,500 *	Nil
Terminal loss			£(11,000)

*There is a profit in the period 1.8.09 to 5.4.10, therefore this is ignored.

The terminal loss which can be carried back 3 years is therefore **£(11,000)**.