SPEAKMAN LAW

Impact of Remission Income on Loss Offsets

This article addresses a company that has a loss on account of expenditure which the company ultimately never pays. The particular context is use of the loss by way of offset against profits of a group company. What happens when the loss company is relieved of the obligation to pay the expenditure?

The answer to that question is considerably more complicated than you might think. The first thing to do is to ask whether the expenditure is "ordinary" or whether it relates to a financial arrangement, ie it is interest.

I will deal first with "ordinary" expenditure for which the company's liability is later cancelled.

In relation to the loss offset, there are three possibilities. First, the loss company and the profit company may remain members of the same group when the liability for the expenditure is cancelled. Secondly, there may have subsequently been a shareholding change to deny continued grouping. Or thirdly, the loss company (or possibly, but less likely the profit company) may have gone into liquidation in the interim.

The position is complicated by the fact that the law in these respects was re-written at the time of the 2004 Tax Act. It has now been re-written again as a result of the 2014 Remedial Tax Act.

Dealing with the easy bit:

a. Upon cancellation of the expenditure (ie the liability for that expenditure), remission income arises in the year in which that cancellation occurs; and

b. It does not arise in the earlier year when the expenditure was claimed and the loss suffered.

A direct consequence of this is that the loss offset in the earlier year remains valid. There is therefore no ability for IRD to clawback the amount of any loss offset.

Does this result change where the loss company is liquidated or struck off when it is still a member of the same group of companies?

New section CG2C now treats the remission income as arising on the date the loss company is liquidated or struck off. It is treated as income of the profit company. This does effectively achieve a clawback of the loss offset.

Is the situation any different when the loss company and profit company cease to be in the same group of companies when the loss company goes into liquidation or is struck off?

New section CG2D applies here. Effectively we reach the same result. The profit company is treated as deriving income equal to the amount of the earlier loss offset (insofar as the loss is occasioned by the subsequently cancelled expenditure). It is treated as having derived that income immediately prior to the two companies ceasing to be members of the same group.

It may be that the loss has been transferred to more than one group company. New section CG2E is intended to apply in that case. That section prescribes that the loss company itself may choose to apportion the income among other companies in the group. Notably reference to "other companies in the group" is not limited to those companies to which the losses were transferred. This appears to be inferred. Where the loss company fails to make an apportionment, a default rule applies. The default rule treats all companies in the group as deriving the income equally. Again it appears to have been inferred that this

applies only to those companies that benefitted from the losses, but strictly, that is not the result. Instead, the section needs to be interpreted as meaning exactly what it says.

These sections mean you need to make an additional enquiry when purchasing shares in a company that has earlier benefitted from a loss offset. That enquiry will need to focus on any possible tax liability that may be triggered by the circumstances discussed above occurring to the loss company.

Neither of these new sections apply to remission income under a financial arrangement. In those circumstances there is effectively no clawback of amounts applied by way of loss offset.

Please let me know if you would like further information.