



Tax Briefing Note 4 Capital loss streaming

Background

- Capital losses can only be carried forward to set against capital gains (rather than, for example, against trading profits). Generally, however, capital gains and losses can be transferred between group companies such that losses in one company can be set against gains in another.
- A company with capital losses is therefore attractive to a group which has gains (or potential gains) and it was common for companies to be bought for their losses (or gains), known as loss/gain buying.
- In order to help prevent this, mechanical rules were designed to restrict the use of losses and gains in companies once they joined another group of companies.
- Then in 2005, a targeted anti-avoidance rule was introduced which restricts the use of losses in cases involving arrangements with a main purpose of obtaining a tax advantage. This rule prevents much of the structuring designed to exploit the use of capital gains and losses.
- As a result of this targeted anti-avoidance rule, much of the complicated mechanical provisions are left redundant and changes have therefore been made to reduce their scope.

2011 changes

- Where a company with an accrued loss joins another group, it can only set that loss against:
 - (a) Gains which accrued before the company became a member of the group
 - (b) Gains that accrue after joining the group on disposals of assets that were owned by the company with the loss; or
- Part (c) above is new in that it allows losses to be set against gains in other group companies and not just the company with the loss. The asset has to be used for the purpose of the same trade or business which was carried on by that company but it does not matter if it is not carried on in that company itself, it can be carried on in one or more other group companies. It also extends the use of the asset on which the gain is made to 'trade or business' rather than just 'trade'.
- The rules previously restricted the use of any loss which was accrued (but not yet realised) at the date of the change in ownership, and complicated provisions determined how the accrued proportion of the loss was calculated. These have now been repealed such that the rules only apply to losses which have actually been realised before the change in ownership (although there are some transitional provisions where a company previously joined a group with an asset standing at a loss).
- Broadly, the changes in 2011 provide some welcome relaxation to the complicated mechanical pre-entry loss rules. However, if it appears that a purchaser is buying a company in order to use its losses (or gains) then this is likely to be caught by the targeted anti-avoidance rules which were introduced in 2005 rather than the more mechanical rules described here. Particular caution would be needed if the purchaser gives any consideration for such losses.

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