Chapter 7

TAX ADJUSTED TRADING LOSSES – INDIVIDUALS

1 Trading losses

1.1 Trading Profit assessment

(a) If the basis period has a trading loss, the trading profit assessment to include in the income tax computation is **nil**.

(b) The trading profit figure in an income tax computation can never be negative

1.2 Relieving the loss

The loss may be relieved according to the following rules. A repayment of income tax may result in some circumstances.

2 The reliefs available

The main reliefs available for a trading loss, are as follows:

(a) Carry forward against future trading profits of the same trade

(b) Relief against total income of current and/or preceding tax year.

(c) Opening years loss relief against total income of preceding 3 tax years

(d) Terminal loss relief against previous 3 years trading profits

3 Carry forward of trading losses

(a) A trading loss may be carried forward and set against the first trading profits arising from the same trade.

(b) The trading loss must be set off in full against the next available trading profit if this option is chosen.

(c) Any loss remaining is carried forward until further profits arise.

(d) The loss may be carried forward indefinitely

Example 1

Albert has had the following recent trading results as adjusted for tax:

		£
Year to 31 December 2012	Loss	(5,000)
Year to 31 December 2013	Profit	3,000
Year to 31 December 2014	Profit	10,000

Assume that Albert chose to carry forward the loss.

Calculate his assessable amounts for all relevant tax years.

4 Loss relief against total income

(a) A trading loss may be relieved against total income (after any qualifying loan interest payments) of the tax year of the loss and/or the preceding tax year.

- the loss is calculated on an accounting period basis.
- a loss for the year ended 30 June 2014 maybe relieved against total income of 2014/15 (the tax year of loss) and/or 2013/14 (the preceding tax year)

(b) If relief against total income is taken,

- the loss must be set off to the maximum possible extent subject to a newly introduced cap on income tax reliefs - see section (c) below
- personal allowances may therefore be lost as total income is before the deduction of the personal allowance and partial claims are not allowed.
- a claim against total income may be made for either the tax year of the loss or the previous year or both. The two years are treated separately and thus a claim is required for each year.

Example 2

Charles has the following trading profit/ (loss) results:

	£
Year ended 31 December 2012	32,000
Year ended 31 December 2013	25,000
Year ended 31 December 2014	(84,000)

Charles also has property income in each year of £6,000.

Calculate Charles' taxable income, assuming that the trading loss is used in the most beneficial way and trading losses will continue for the next few years. Assume the personal allowance for 2014/15 applies in all tax years.

(c) A cap was introduced in FA 2013 limiting the amount of loss relief available against a person's total income. The cap is the higher of:

- £50,000, or
- 25% of person's adjusted total income

Adjusted total income is after deducting the gross amount of any personal pension contributions.

Importantly the cap does not apply to any trading profits within the total income figure (this would be relevant to a claim made in respect of the preceding tax year).

The cap will only be tested at F6 within this section of relief against total income of current and / or the preceding tax year.

Illustration

Louise Serr has always prepared accounts to April 5 in each year in respect of her trade while also receiving employment income of £60,000 each tax year. For the year ended April 5, 2015 she made a trading loss of £125,000 having made a trading profit of £20,000 in the year ended April 5, 2014.

Assume the personal allowance for 2014/15 also applied in 2013/14 and compute the taxable income for each of these tax years assuming that loss relief claims against total income are made in both tax years.

	2013/14	*2014/15*
	£	*£*
Trading Profit	20,000	Nil
Employment Income	60,000	60,000
	80,000	60,000
Loss Relief	(70,000)	(50,000)
	10,000	10,000
Personal Allowance	(10,000)	(10,000)
Taxable Income	-	-

Loss relief claim in 2014/15 is capped at £50,000 as this is higher than £15,000 (25% x 60,000).

In 2013/14 the loss relief claim is made in full against the trading profit but the cap of £50,000 then applies against the remaining total income (employment income).

The cap can here be seen in fact to be of advantage to Louise as it leaves sufficient total income in both years to absorb the available personal allowance.

The remaining trading loss of the year of £5,000 (125,000 – 50,000 – 70,000) will be carried forward to set off against the next available trading profit of the business.

(d) Relief of trading losses against capital gains

(i) This relief is an extension to current year and carryback relief against total income and may only be claimed after such a claim has been made against the total income of the tax year of claim.

(ii) A trading loss may be relieved against capital gains, but only after the total income of the year in question has been reduced to zero by the trading loss under a normal claim, and an unrelieved loss still remains.

(iii) The remaining unrelieved trading loss may be set off as a deemed capital loss against the taxpayer's gains for the year; after setting off current year capital losses against current year capital gains. It takes precedence over both the annual exemption (a level of tax free gains and currently £11,000) and any capital losses brought forward (see details in chapter 12).

Example 3

For 2014/15 Kathy has a capital gain of £44,000. She has trading loss relief available of £24,000 after a claim against the total income of the tax year has been made.

Calculate Kathy's chargeable gain for 2014/15, assuming that Kathy makes the election.

5 Losses in opening years

In the first tax year of the trade the assessable profit (or loss) is measured from the day trade commences to the following 5 April.

Unless the trader prepares accounts to 5 April, this requires the profit (or loss) to be apportioned.

- A loss may only be relieved once. If, in the opening years, a loss has been taken into account in computing the assessment of one tax year, it is treated as nil when calculating the next assessment.

Example 4

Matthew starts trading on 1 August 2013. His trading results, as adjusted for tax purposes are:

		£
10 months to 31 May 2014	Loss	(20,000)
Year ended 31 May 2015	Profit	48,000

Calculate Matthew's trading profit assessments and the losses available for relief in respect of all relevant tax years.

5.1 Opening years loss relief

(a) The relief is available for losses incurred in the first four tax years of trading.

(b) Relief is available against total income of the three tax years preceding the tax year of loss.

There is no need for the trade to have been carried on in these preceding tax years

(c) The relief operates against all three preceding tax years on a FIFO basis. As with current and preceding year relief partial claims are not available and hence personal allowances may again be lost

(d) The loss available for this relief is computed in the same way as profits.

(e) In the early years of the trade it is possible to claim the following reliefs:

- » Opening years loss relief
- » Relief against total income of the current and/or previous tax year, including possible extended claim against gains
- » Carry forward against future trading profit

Example 5

Fiona started trading on 1 July 2013. Her results, as adjusted for tax purposes, for the first two years are as follows:

		£
Year ended 30 June 2014	Loss	(12,000)
Year ended 30 June 2015	Profit	2,500

Fiona had previously been employed.

Her remuneration from this employment, which ceased on 30 September 2012, for recent years was:

	£
2012/13	5,868
2011/12	11,050
2010/11	12,800

Fiona has other income of £4,500 (gross) p.a.

Calculate the taxable income for all years after claiming opening years loss relief.

Assume the personal allowance for 2014/15 applies throughout.

6 Terminal loss relief

(a) The terminal loss is set against trading profit for the tax year of cessation (if any - note this is usually a nil assessment given the loss arising) and then the previous three tax years on a LIFO basis.

(b) The terminal loss is the loss of the final 12 months of trading computed in 2 parts dividing the last 12 months of trading between the final and penultimate tax years, calculated as follows:

(i) The actual trade loss for the tax year of cessation (from 6 April to the date of cessation) including any overlap relief arising from opening years.

(ii) The actual trade loss for the period 12 months before cessation until the end of the penultimate tax year

If the result in i) or ii) is a profit it is treated as zero for purposes of the terminal loss computation.

Example 6

David has the following trading results before ceasing to trade on 31 May 2015

		£
Year ended	31 July 2013	18,000
Year ended	31 July 2014	6,000
10 months	31 May 2015	(20,000)

Show the loss available for relief under terminal loss relief, assuming overlap profits on commencement were £500 and state how this loss would then be relieved

Students may now attempt Practice Questions 16 & 17