Slice with care

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Tax relief claims are under review, but businesses can lose money with grace and efficiency, says Julie Butler

HMRC is looking closely at income tax loss claims. From 6 April 2013, this was emphasised by the capping of income tax losses to 50,000 per annum or 25 per cent of an individual's total income, whichever is the greater. There are other areas of scrutiny of the validity of a loss claim by HMRC, for example the ten-hour rule and proof of commerciality.

In addition to income tax losses, on which a taxpayer may wish to obtain tax relief, there are capital losses, for example loans to traders and shares. HMRC is also reviewing such claims. Where an individual lends money to a trade that subsequently becomes irrecoverable, partially or in full, relief may be found in section 253 of the Taxation of Chargeable Gains Act 1992. "Trade" is defined to include a profession or vocation, but explicitly excludes "a trade which consists of or includes the lending of money" (section 253(1)(a)).

Loans are not defined in the legislation, and may be in the form of cash, bank overdrafts, a bank loan (to repay a loan taken out to lend to a trader) or simply a credit balance in a director's loan account.

A basic loan that taxpayers want to claim tax relief on is the director's loan account (DLA). HMRC is not prepared to allow tax relief unconditionally.

DLA conditions

Where there are reasons for an inspector to believe that there are still reasonable prospects of the loan being able to be repaid in future, tax relief cannot be obtained. *Practical tax tip: do not rush the claim. What do the business plans and director's minutes show? What are the intentions of the directors? Can it be proved the loan cannot be repaid?*

Where the borrower continues to trade (subject to further examination of precise circumstances), even at a loss. This, in HMRC's view, is a sign of potential recoverability (CG65950) of the loan and the loss relief cannot be obtained. Has the trade ceased or is it continuing? What will happen with the trade? Often directors are not prepared to 'throw in the towel'.

Where the lender makes further loans to the business following the making of a claim for relief (CG65957). For example, when a claim for the DLA loss has been made and the director still pumps money into the business the capital gains tax (CGT) loss claim will be denied.

Where the borrower's trade was already in such difficulty when money was lent that the loan may be regarded as irrecoverable from the outset (CG65951).Lending money into an owner-managed business via a DLA when the business is in real trouble will mean that the DLA cannot qualify for CGT loss relief.

Where the loan is converted into shares or securities, even though these may themselves be worthless (CG65934). Shares or securities acquired under these circumstances are also unlikely to obtain relief under a "negligible value claim". If an individual has invested in shares or securities in a company, be it quoted orunquoted, and their value has become negligible, there may be relief as per section 24 of the Taxation of Chargeable Gains Act 1992 under a "negligible loss" relief claim for CGT. This relief gives rise to an allowable capital loss in the tax year in which the claim is made and admitted by HMRC.

Income tax

HMRC is not going to allow the tax relief without question. Evidence and documentation are key. Original business plans to show the operation would and could make money and how this would be achieved is essential.

It is possible for businesses to be 'blown off course' (*Walls v Livesey*) in terms of profitability as there was a particular circumstance that caused the problem, which helps the argument for the income tax loss relief.

The key fact for showing HMRC that the business was structured to make a profit, i.e. that sale proceeds cannot just exceed production costs but also cover overheads and that the income tax loss claim is therefore allowable.

Losing money is a fact of business life and there are tax reliefs to be claimed in respect of that. However, whether a capital or income loss, it is important to ensure maximum tax relief is claimed and that there is evidence to support this.

Julie Butler is a partner in Butler & Co. She is the author of Tax Planning for Farm and Land Diversification*,* Equine Tax Planning *and* Stanley: Taxation of Farmers and Landowners