Revised rules for utilising tax losses carried forward

+27 83 417 5904 pieter@pvdz.co.za www.pvdz.co.za

The amendments to the assessed loss provisions in section 20 of the Income Tax Act become effective for most companies for their financial years that begin on or after 1 April 2022. The amendments restrict the utilisation of assessed losses carried forward from prior years against current year taxable income. This article provides a brief overview of the changes and some examples to demonstrate the practical workings of the restrictions.

The reduction in the corporate tax rate to 27% triggers the effective dates for two sets of amendments made during 2021. One of these amendments relate to the utilisation of assessed losses carried forward by companies. This article provides a brief overview of the changes to these rules and some examples to demonstrate its workings.

Context

The reduction in the corporate tax rate involves a larger balancing act by the National Treasury. While the rate reduction reduces revenue for the state, measures to broaden the corporate tax base neutralise this loss to leave the fiscus in a position where its overall revenue is not expected to be affected. Two base broadening measures were announced in 2021. These affect the utilisation of tax losses carried forward as well as the scope and thresholds of the interest deduction limitation.

The effective dates for the base-broadening amendments are linked to the date on which the corporate tax rate is first reduced after being announced by the Minister of Finance and apply to years of assessment that begin on or after this date. The effective date for the rate reduction was announced on 23 February 2022. Interestingly, it was announced with reference to the *end* of years of assessment - it applies to any year of assessment that ends on or after 31 March 2023. Practically, this rate, and therefore the assessed loss amendments, apply for years of assessment that begin from 1 April 2022 onwards.

Practical workings

Despite being a significant change in policy, the amendment to section 20 is relatively short. Currently, a company can set the full balance of any assessed loss that it carries forward from a previous year off against income derived from a trade to determine its taxable income for the current year. The revised rule states that a company can only utilise such a balance of assessed loss carried forward from a prior year in the current year to the extent that the set-off does not exceed the higher of:

- R1 million, or
- 80% of the company's taxable income before the balance of the assessed loss is taken into account.

The company does not forfeit the balance of the assessed loss that it could not utilise. This amount is carried forward. The amendment affects the timing when it finally utilises this amount. Some practical worked examples further illustrate the effect of the revised rule.

Company profitable in the current year

Company A realises a taxable income of R10 million for the current year before its prior year assessed loss of R50 million is taken into account. The effect of the new rule is that Company A can only offset the higher of R1 million or R8 million (being R10 million x 80%) of this prior year assessed loss against its current year taxable income. This means that Company A has taxable income for the current year of R2 million (being R10 million less the balance of the assessed loss utilised of R8 million). It is liable for normal tax at 27% on this taxable income. The un-utilised balance of an assessed loss of R42 million (being R50 million less R8 million) carries forward to its next year of assessment.

Companies affected by the restriction are those:

- that become profitable on a year-on-year basis after their businesses required significant capital outlay upfront that caused assessed losses to accumulate,
- with cyclical businesses that realise losses in some years and profits in others (like farming businesses),
- that faced temporary setbacks and suffered losses (for example during the Covid-19 pandemic), but then recover to become profitable again.

The *de minimis* threshold provides relief for companies whose taxable income for the year, before taking into account prior year losses, does not exceed R1 million.

Company loss-making in the current year

If Company A realised an assessed loss of R10 million for the current year, it should, in principle, not be affected by the amendment. Company A would add its balance of assessed loss from a previous year to the assessed loss for the current year and carry this amount forward for the next year of assessment as the balance of the assessed loss. Assuming the company's balance of assessed loss was R50 million again, it would carry forward R60 million (R10 million for the current year plus a balance carried forward of R50 million) to its next year of assessment. The amendment will affect Company A when it starts utilising the balance of the assessed loss.

+27 83 417 5904 pieter@pvdz.co.za www.pvdz.co.za