Income tax verification: Assessed losses

Following the discontinuance of the IT14SD, SARS now requests specific information from companies to verify their income tax returns. I noted some patterns in the information requested from taxpayers. This article provides some insight into the information requested from companies that have assessed losses.

SARS did away with the IT14 supplementary declaration for companies (IT14SD) in September 2022. It replaced that declaration with a letter that requests supporting documents based on the reason for the verification. This article considers a recurring request to taxpayers with assessed losses.

Information requested: Assessed losses

I noted that SARS requests the following information (same wording, even the grammar and typing errors) from many companies that have assessed losses:

- *Confirm that the company has a bona fide intention to make a profit.*
- *Explanation as to why the company is making assessed losses, and an indication as to when profits will be realised.*
- *A copy of the business plan/feasibility study that indicate the future profitability of the enterprise*
- *Provide reason(s) as to why the assessed loss should not be ring-fenced in terms of s20(1)A of the Income Tax Act Act.*

This short article aims to assist taxpayers who need to provide this information with some context as to its relevance regarding the assessed losses that they carry forward.

Intention, cause of loss and business plan

Section 20 of the Income Tax Act deals with assessed losses. An assessed loss is "any amount by which the deductions admissible under section 11 exceeded the income in respect of which they are so admissible".

The deductions that give rise to the assessed loss may be allowed in terms of specific deductions available to a particular type of transaction or business. In addition to these provisions' specific requirements, many require that a taxpayer carry on a trade to qualify for a deduction or allowance. In the absence of a specific deduction or allowance, the general deduction formula in section 11*(a)* read with sections 23*(f)* and 23*(g)* provide the deduction. The general deduction formula requires that a taxpayer incur expenditure, not of a capital nature, in the production of income for purposes of carrying on its trade.

Therefore, carrying on a trade is central to most deductions contributing to an assessed loss. To carry on a trade generally requires a profit motive, which the first question seems to establish. The following two questions appear to aim at understanding the taxpayer's trade.

The cumulative assessed loss carried forward from a previous year of assessment is the balance of an assessed loss. A company may only carry the balance of an assessed loss forward from one year to the next if it carried on a trade during the year of assessment. The questions aimed at understanding the taxpayer's trade, arguably, also relate to this requirement.

Ring-fencing

The last question's purpose is unclear. Section 20(1) does not have a subparagraph (A) (or A). If the question intended to refer to section 20A(1), that provision only applies to certain natural persons. SARS could consider clarifying this question to companies to avoid unnecessary uncertainty.

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