

Assessed losses: Is this the right time to introduce limitations?

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In terms of current law, taxpayers may set-off the balance of their assessed loss carried forward from a prior tax year (“Year 1”) against income of the current year (“Year 2”). Provided a taxpayer carries on trading operations, it is entitled to carry forward its unutilised assessed loss balance to future years of assessment to set off against future income with the effect that the taxpayer will only become liable for income tax once their assessed loss is depleted and they realise taxable income.

The Draft Taxation Laws Amendment Bill, 2021 (“the Draft Bill”) proposes to restrict the ability of a company to set off its assessed loss carried forward from Year 1 against its income in Year 2. It is proposed for this amendment to come into operation on 1 April 2022 and to apply in respect of years of assessment commencing on or after such date.

Should the proposal be enacted, it would mean that a company would only be able to set-off the balance of its assessed loss carried forward against 80% of its taxable income. The balance of its assessed loss remaining thereafter will be carried over to the succeeding year of assessment. For example: If Company A has an assessed loss carried forward from Year 1 of R200, and taxable income of R100 in Year 2, the proposed amendment would have the effect of Company A only being entitled to set off R80 of its assessed loss against its taxable income in Year 2. Accordingly,

Company A would pay income tax on taxable income of R20 in Year 2 and carry a balance of assessed loss in the amount of R120 to Year 3.

The rationale for the proposed restriction in the ability of a company to utilise its assessed loss is to bring South African assessed loss rules in line with the global trend to restrict the use of assessed losses. In addition, as was announced by the Minister of Finance in the Budget Speech of February 2020, the intention of Government is to reduce the South African corporate income tax rate over the medium term to promote economic growth, and the proposed restriction on the use of assessed losses is intended to assist with the expansion of the corporate tax base in order for the reduction of the corporate tax rate to be possible without loss to the *fiscus*.

Having regard to the current state of the economy and further impact of COVID-19, concern has been raised as to the negative impact the proposed amendment will have on struggling business – particularly as they adjust to the current economic climate and start to generate income.

Accordingly, submissions were made to National Treasury to consider including a *de minimus* rule in the proposed legislation to ensure that small and medium-sized business are not adversely affected by these limitation rules. An alternative submission was that the proposal be phased in over a number of years of assessment (e.g., for assessed losses carried forward to be available for set-off against 95% of a year of assessment's income, 90% in the year thereafter, and 80% in the succeeding year).

Although National Treasury and SARS indicated that exclusions to the proposed assessed loss limitation rules may create unnecessary complexity, given the current economic climate, it will be interesting to see how this is enacted.

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