SET OFF AND CARRY FORWARD OF LOSSES

Swipe

BACKGROUND

Every business aspires to earn profits in business, at the earliest. That said, risk and losses are never far away. Tax laws of countries recognize this and provide for utilization of losses against income in future periods.

Tax losses have a value and therefore a deferred tax asset is created in the books.

In case of business acquisitions, many countries subject to conditions allow the acquirer entity to set off the losses of the acquired entity against its taxable profits. This could result in a tax benefit, as tax losses can be set-off against future taxable income.

UNDERSTANDING THE VALUE OF TAX LOSS

Can a loss-making company be an attractive target?

For example, Google acquired loss-making company Motorola and Motorola's $ 700 million operating loss resulted in a tax benefit to Google.

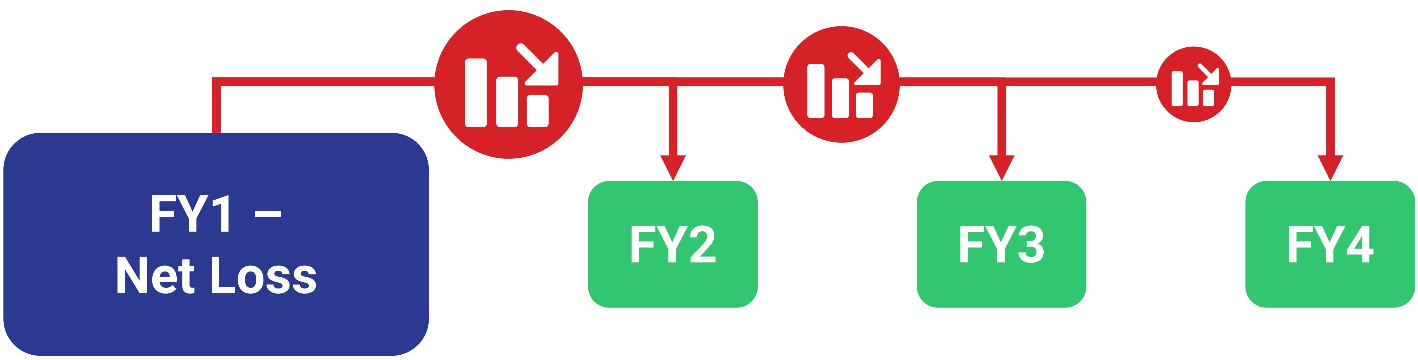
SET OFF AND CARRY FORWARD OF LOSSES

SET OFF OF LOSSES:

Set off means adjustments of losses against the profits. Some countries allow offsetting the losses against a similar nature of income while others have more liberal rules that allow set-off against sources of income in the same financial year.

CARRY FORWARD OF LOSSES:

If the loss cannot be fully set off due to inadequacy of income, such loss may be carried forward to subsequent years for set-off.



RELEVANCE FOR UAE CT

The losses incurred by a business, before it becomes a taxpayer under the corporate tax regime, will not be allowed to be set-off.

CARRY FORWARD OF LOSSES

Any business loss incurred after it becomes a taxpayer under the corporate tax regime can be carried forward for an unlimited period and adjusted against future profits. However, such set-off will be limited to 75% of taxable income in such year and balance will be carried forward.

TRANSFER OF LOSSES

Also, tax losses can be transferred within the group companies (**75% commonly owned entities**). However, Free Zone entities subject to 0% CT rate cannot transfer their losses to a taxable group entity.

RELEVANCE FOR UAE CT (CONT.)

CARRY FORWARD OF LOSSES ON RESTRUCTURING

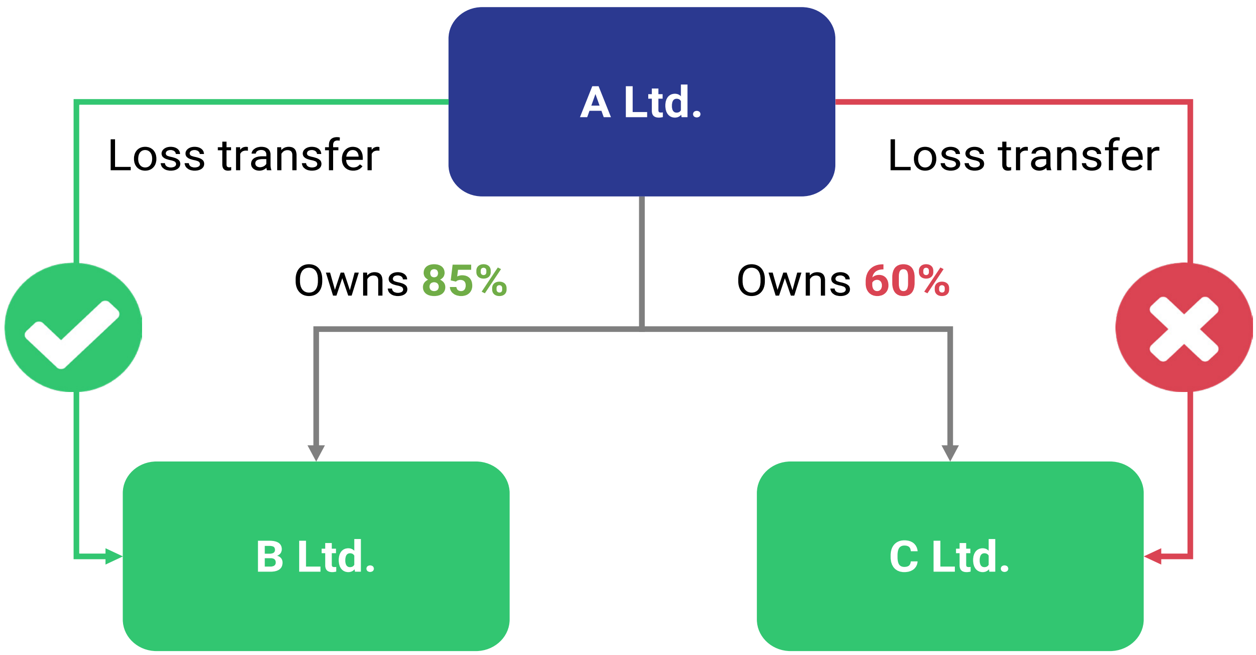
Whether losses are lost in case an entity goes through restructuring?

In case of restructuring, if the change in shareholding is more than 50% in case of unlisted entities, tax losses can be carried forward if the new owners continue the same or similar business activity.

The scenarios on next page will help in understanding the provisions:

SCENARIO 1

Company	Holding (%)	Profit/ (Loss) in AED	Applicable CT rate
A Ltd		(1,500,000)	9%
B Ltd	85% held by A Ltd	1,800,000	9%
C Ltd	60% held by A Ltd (remaining 40% is outside the group)	1,750,000	9%



Loss of A Ltd can be transferred to B Ltd but not C Ltd (as C Ltd is not 75% or more commonly held).

Losses of A Ltd can be adjusted up to 75% profits of B Ltd i.e., up to AED 1,350,000. Balance losses of A Ltd (AED 150,000) to be carried forward for the future period.

SCENARIO 2

A Ltd acquired B Ltd (tax losses of AED 1,300,000) by transfer of shares. Now, both A Ltd and B Ltd are the same group companies.

Can A Ltd offset the tax losses of B Ltd against its taxable income of AED 1,500,000 ?

Losses of B Ltd can be adjusted up to 75% of the taxable income of A Ltd i.e., AED 1,125,000 if same or similar business of B Ltd is continued and balance losses of AED 175,000 can be carried forward for set off against future profits.

FINAL THOUGHTS:

Businesses need to look at carry forward and set-off of loss related provisions carefully.

This would impact businesses with long gestation period and in the start-up phase. Their losses incurred before UAE corporate tax effective date will not be available and profits earned will become taxable in the tax regime.

In case you have business in UAE with multiple group entities, time to evaluate:

- ✓ Tax losses and its eligibility for carry forward
- ✓ Eligibility to transfer losses from one entity to another group entity
- ✓ Tax grouping of entities

Going forward, in case of deals, the tax loss value cannot be ignored, and this could potentially change the purchase consideration.

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