# Tax Alert

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## Let's talk

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# Limitation of set-off of assessed losses for companies

## In brief

A significant change to the set-off of assessed losses against the taxable income of a company is imminent. Corporate taxpayers who have not yet considered the potential implications of this on upcoming provisional tax payments have less than two months left to do so.

## In detail

### General

As announced by the Minister of Finance in the 2022 Budget, the corporate income tax rate will be reduced from 28% to 27%, effective for years of assessment ending on or after 31 March 2023 (i.e. for years of assessment beginning on or after 1 April 2022, with the possible exception where a financial year has changed).

To ensure that this rate reduction takes place on a revenue-neutral basis, certain tax base broadening measures become effective from the same date.

One of these measures is a limitation on the utilisation of assessed losses by companies.

The amended provision (section 20 of the Income Tax Act No. 58 of 1962) reads as follows:

*"For the purpose of determining the taxable income derived by any person …, there shall, …be set off against the income so derived by such person - that is a company, any balance of assessed loss incurred by that person in any previous year which has been carried forward from the preceding year of assessment, to the extent that the amount of such set-off does not exceed the* ***higher of R1 million and 80 per cent of the amount of taxable income*** *determined before taking into account the application of this provision".* [Our emphasis]

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We summarise the tax consequences of the assessed loss limitation for companies for years of assessment ending on or after 31 March 2023 below.

*De minimus provision*

If a company's taxable income amounts to R1 million or less, there is no restriction on the set-off of the assessed loss balance carried forward from the prior year, against the current year's taxable income.

*Taxable income exceeding R1 million*

If the company's taxable income exceeds R1 million in respect of that year of assessment, the assessed loss balance carried forward that may be set off against that year's taxable income is the lesser of -

i. the actual assessed loss balance carried forward to that year; or
ii. the greater of 80% of the current year's taxable income and R1 million.

Any balance of the assessed loss brought forward from the preceding year of assessment which exceeds this limitation may be carried forward to the immediately succeeding year of assessment, to be set off against the taxable income for that year, but still being subject to the limitations set out above.

We illustrate in the table below the income tax consequences of the application of the assessed loss limitation provision.

| Year | 1 | 2 | 3 | 4 |
|---|---|---|---|---|
| | R | R | R | R |
| Current year taxable income | (5,000,000) | 1,000,000 | 1,500,000 | 2,500,000 |
| | | | | |
| Assessed loss from prior year 80% of current taxable income<br>*De minimis* allowance | 0 | (5,000,000)<br>800,000<br>1,000,000 | (4,000,000)<br>1,200,000<br>1,000,000 | (2,800,000)<br>2,000 000<br>1,000,000 |
| | | | | |
| Assessed loss allowed | 0 | (1,000,000) | (1,200,000) | (2,000,000) |
| | | | | |
| Taxable income/ (Assessed loss) | (5,000,000) | 0 | 300,000 | 500,000 |
| | | | | |
| Balance of assessed loss c/f | 0 | (4,000,000) | (2,800,000) | (800,000) |
| Tax payable | 0 | 0 | 81,000 | 135,000 |

**Mining companies**

There is currently an anomaly in the ordering between the application of the assessed loss restriction rules (in section 20) and the capital expenditure deduction (in terms of section 36). The Draft Revenue Laws Amendment Bill, 2022 proposes to address this anomaly by clarifying (through an amendment to section 20), that the limitation calculation should be performed prior to considering the capital expenditure deduction in terms of section 36.

## Takeaway

Corporate taxpayers should be mindful of the new limitation on the set-off of an assessed loss balance carried forward from the prior year.

Noting the effective date, i.e. effectively applicable for years of assessment commencing on or after 1 April 2022, the impact (if any), for a corporate taxpayer, of the limitation provision will have to be considered for provisional tax payments due on or after 30 September 2022.

Accordingly, companies should consider the potential cash flow implications of the limitation on the utilisation of the assessed loss balance as (depending on the facts) a company may now have a provisional tax liability, whereas previously (prior to the amendment) this may not have been the case.

In addition, it will be important to apply the provision correctly when performing the provisional tax calculation, to avoid the potential imposition of any underestimation penalties that may be levied by SARS.