

Chapter 17

Revenue

Loss Reliefs

Loss Reliefs

17.1 In line with practice in other OECD countries, Irish tax legislation makes provision for businesses that incur losses to offset those losses against taxable profits in certain circumstances and subject to certain conditions and restrictions. Provision is also made for certain losses to be carried back against previous year's profits¹³⁰ and carried forward against future profits.

Chapter Focus

The audit set out to establish

- the extent to which the loss relief provisions of tax legislation had been used by companies in recent years
- whether Revenue had identified the level of losses being carried forward and the likely effect of this on future tax collection
- whether there were significant differences between economic sectors in the occurrence of losses and in the extent to which losses are being carried forward.

It focused specifically on Corporation Tax.

Loss Relief Provisions – Corporation Tax

17.2 The figures quoted in the chapter are the amounts of losses claimed or used. The effect of loss relief on a company's tax computation depends on the rate of Corporation Tax applicable to the activities that generate the loss

- The standard rate of Corporation Tax of 12.5% applies to trading profits.
- Relief is available whereby trading profits from certain manufacturing and other activities are effectively taxed at 10%. This relief, commonly known as manufacturing relief, is being phased out and will no longer be available after 31 December 2010.
- Non-trading income is taxed at 25% as is trading income from 'excepted trades', which includes dealing in land and trading income from mining and petroleum operations.

Use of Loss Reliefs

17.3 In general, a company's trading losses can be offset against trading profits of the same accounting period or the preceding accounting period of corresponding length. Trading losses can also be set off against current and previous year profits of activities assessable at the 25% Corporation Tax rate but relief is given on a value basis¹³¹. Any unused losses can be carried forward against future profits of the same trade indefinitely but must be used against the earliest available profits. Group relief also allows one member of a group of companies to surrender its trading loss to another group member but only for the current accounting period i.e. losses carried forward or back cannot be transferred to other group companies. A trading loss incurred in the last

¹³⁰ Carry back of losses is only available to companies chargeable to Corporation Tax. It is not available to sole traders and partnerships where the persons are chargeable to Income Tax.

¹³¹ This ensures that the value of any loss relief allowed remains the same irrespective of the rates of tax that apply to the activities concerned.

twelve months of a discontinued trade may be carried back and set against trading income of the same trade in the three preceding years.

17.4 Losses incurred by a company from the rental of land or property in the State can be carried back for offset against rental income in the preceding accounting period or carried forward for offset against future rental income. Other non-trading losses can be offset against income of the same type in the same period or carried forward against future profits of the same type. Capital losses are not allowable against trading or non-trading income but may be offset against capital gains of the same accounting period or carried forward against capital gains in future accounting periods.

17.5 In order to deter late submission of returns, there are restrictions on the use of a number of reliefs including certain loss reliefs. Where a return is submitted late, the extent to which a loss can be used is restricted so that profits in any period are reduced by no more than 50% of the amount otherwise available, subject to a maximum restriction of €158,715. Where the return is less than two months late, the restriction is reduced to 25% or a maximum of €31,740. There is no restriction on carry forward of losses.

17.6 The transfer of a trade from one company to another constitutes the discontinuance of that trade and means that trading losses are not available for carry forward. However, unused losses of a trade that is transferred from one company to another may be used by that other company where it carries on the trade and an interest in the trade of not less than 75% is held by the same persons before and after the change. Carry forward of losses is disallowed if there is both a change in ownership and a change in the nature or conduct of the trade or if at the time of change of ownership, the trade carried on has become small or negligible. This latter provision is to counter the tax-avoidance device known as 'loss buying'.

Loss Relief Claimed

17.7 Companies are required to make their final Corporation Tax return nine months after the end of their accounting period. It is not until this return is made that information is available to Revenue on the extent to which losses have been incurred. For example, Corporation Tax returns for accounting periods ending December 2008 were required to be submitted by September 2009.

Trading Losses

17.8 Revenue provided details of trading losses included in Corporation Tax returns for accounting periods ending in 2007 and 2008 and these are set out in Figure 89.

Figure 89 Trading Losses – Corporation Tax Returns 2007 and 2008

	Accounting Periods ending in			
	2007		2008	
	€m	€m	€m	€m
Trading Losses in the Period				
Activities taxed at standard rate	13,774		16,500	
Activities eligible for 10% rate	207		882	
		13,981		17,382
Trading Losses Carried Forward from Earlier Periods				
Activities taxed at standard rate	5,433		11,185	
Activities eligible for 10% rate	420		510	
		5,853		11,695

17.9 On an aggregate basis, Revenue's computer systems do not generate data in relation to the amount of losses actually used in any year. Neither is there provision on Revenue's systems for recording details of losses unused and available for carry forward to future years. Therefore, while the amounts in Figure 89 show the trading losses that were included in the Corporation Tax returns in periods ending in a particular year as well as those carried forward from earlier periods, the extent to which relief for these losses has been obtained would not be available without further computer development work.

Trading Losses by Sector

17.10 The trading losses in each period and the amounts carried forward from earlier periods as shown in Figure 89 above are analysed by economic sector in Figure 90, which combines the losses from activities taxed at the standard rate with those taxed at the 10% rate.

Figure 90 Trading Losses by Sector 2007 and 2008

Sector	Accounting Periods ending in			
	2007		2008	
	Losses in Period €m	Losses Forward €m	Losses in Period €m	Losses Forward €m
Agriculture, Hunting and Forestry	102	69	145	64
Fishing	13	22	22	20
Mining and Quarrying	12	13	21	14
Manufacturing	1,569	579	1,465	762
Electricity, Gas and Water Supply	25	114	48	181
Construction	436	358	998	390
Wholesale and Retail Trade	497	596	841	553
Hotels and Restaurants	571	300	160	333
Transport, Storage and Communications	495	318	692	323
Financial Intermediation	8,815	1,546	9,024	5,777
<i>of which</i>				
<i>State Guaranteed Financial Institutions^a</i>	27	0.5	355	–
Real Estate, Renting and Business Activities	1,120	1,705	3,710	2,992
Public Administration and Defence	16	2	7	1
Education	17	16	16	20
Health and Social Work	49	31	55	36
Community, Social and Personal Services	239	167	176	227
Activities of Households	–	–	–	–
Extra-Territorial Organisations	–	3	–	–
All Other Sectors/Unknown	5	14	2	2
All Sectors	13,981	5,853	17,382	11,695

Note:

- a Included here are institutions covered by the Credit Institutions (Financial Support) Scheme 2008 made pursuant to Section 6(4) of the Credit Institutions (Financial Support) Act 2008 and other companies within their group.

17.11 The impact of trading losses in 2007 and 2008 was greatest in the financial intermediation sector. Of the €8.8 billion trading losses in 2007 in this sector, 85% (€7.5 billion) related to three companies. Just over half of the €9 billion losses in 2008 arose in five companies. 90% of the €5.8 billion losses forward in 2008 refers to one company.

17.12 This sector includes the major financial institutions and included in the 2007 figures is a loss of €6.5 million in respect of one of the seven institutions covered by the bank guarantee scheme (the covered institutions). In 2008, the covered institutions, including companies within their group recorded losses in the period totalling €55 million in their Corporation Tax returns. As the data is for accounting periods ending in 2007 and 2008, it does not include losses incurred for periods ending in 2009 and 2010¹³². Losses in this sector for 2009 and 2010 are likely to be significant due to the impairment charges on loan assets. The losses before tax for the five financial institutions receiving support from the State as shown in each institution's latest available audited accounts are summarised in Figure 91.

Figure 91 State Supported Financial Institutions - Results per Audited Accounts

Financial Institution	Accounting Period	Profit (Loss) Before Tax €m	Prior Year Profit (Loss) €m
AIB Group	31 December 2009	(2,656)	1,034
Anglo Irish Bank Corporation Limited	31 December 2009	(12,829) ^a	784 ^b
Bank of Ireland	31 December 2009	(1,813) ^c	(23)
EBS Building Society	31 December 2009	(99)	(38)
Irish Nationwide Building Society	31 December 2009	(2,478)	(280)

Notes:

- a For 15 months ended 31 December 2009.
- b Prior year is year ended 30 September 2008.
- c For nine months ended 31 December 2009.

17.13 Further losses are likely to be recognised by these institutions in 2010 as loan assets are transferred to the National Asset Management Agency (NAMA) and additional impairment losses are recognised.

17.14 The extent to which these losses can be used to offset any future profits is restricted. The National Asset Management Agency Act 2009 amended the Taxes Consolidation Act 1997 to restrict the use of losses by participating¹³³ institutions in accounting periods commencing after the passing of the NAMA Act. The maximum amount of losses carried forward that can be used in each period is half of the excess of group trading profits over group trading losses for that period, so that a minimum of 50% of group trading profits will remain chargeable to tax in each period. This restriction effectively lengthens the period of time over which loss relief may be used by the participating institutions.

¹³² Corporation Tax returns are due to be submitted nine months after the end of the accounting period.

¹³³ There are five credit institutions participating in the NAMA scheme – three banks and two building societies.

Loss Relief on a Value Basis and Carry Back of Losses

17.15 The Corporation Tax returns also show the extent to which loss relief on a value basis was claimed as well as claims for carry back of losses to earlier accounting periods and group relief. The extent to which these reliefs were claimed for 2007 and 2008 is shown in Figure 92.

Figure 92 Claims for Loss Relief on a Value Basis, Carry Back of Losses and Group Relief for 2007 and 2008

	Accounting Periods ending in			
	2007		2008	
	€m	€m	€m	€m
Loss Relief on a Value Basis^a				
Activities taxed at standard rate	837		1,431	
Activities eligible for 10% rate	49		72	
		886		1,503
Claims for Carry Back of Losses		292		1,573
Claims for Group Relief		3,321		8,357
Total		4,499		11,433

Note:

- a The figures for loss relief on a value basis represent the amount of losses where a value limitation applies, not the total loss relief provided in the period.

17.16 Revenue has indicated that the amounts shown for loss relief in Figure 92 represent loss relief for use in the period. However, as the figures are from the tax returns submitted, they may be subject to change following processing and assessment in Revenue. Therefore, the overall amounts of these losses actually used in the period may be different.

17.17 A sectoral analysis of the loss relief on a value basis and claims for carry back of losses for 2007 and 2008 is set out in Figure 93.

Figure 93 Loss Relief on a Value Basis and Carry Back of Losses 2007 and 2008

Sector	Relief on a Value Basis		Carry Back of Losses	
	2007 €m	2008 €m	2007 €m	2008 €m
Agriculture, Hunting and Forestry	17	22	1	1
Fishing	4	5	–	1
Mining and Quarrying	3	5	–	2
Manufacturing	88	310	24	130
Electricity, Gas and Water Supply	4	12	–	1
Construction	136	313	41	167
Wholesale and Retail Trade	121	179	25	125
Hotels and Restaurants	62	59	2	6
Transport, Storage and Communications	93	96	4	31
Financial Intermediation	26	67	160	929
Real Estate, Renting and Business Activities	290	392	33	167
Public Administration and Defence	9	–	–	1
Education	3	6	–	1
Health and Social Work	4	7	–	1
Community, Social and Personal Services	24	28	2	10
Activities of Households	–	–	–	–
Extra-Territorial Organisations	–	–	–	–
All Other Sectors/Unknown	2	2	–	–
All Sectors	886	1,503	292	1,573

17.18 The use of loss relief on a value basis increased from €886 million in 2007 to €1,503 million in 2008. The sectors which were most affected were manufacturing, construction and the real estate, renting and business activities sector. Claims for offset of losses against earlier accounting periods increased by €1,281 million to €1,573 million between 2007 and 2008. 60% of this increase was in respect of companies in the financial intermediation sector.

Other Losses

17.19 Relief for rental losses can only be carried back or forward against other rental profits. The Corporation Tax return captures details of rental losses carried forward from previous accounting periods and these totalled €14 million in 2007 and €150 million in 2008. The extent to which these amounts have been used is not known.

17.20 Losses on disposals of capital assets in 2008 were €1.8 billion. Capital losses brought forward from previous periods were €1.2 billion and unused losses carried forward to future accounting periods totalled €1.6 billion. Capital losses may only be offset against capital gains.

Capital Allowances

17.21 For Corporation Tax purposes, capital allowances are allowed as a trading expense. A loss created or augmented by capital allowances is treated as a trading loss. Revenue provided data in relation to capital allowances claimed by companies for accounting periods in 2007 and 2008. The data was for companies who had recorded a loss. Details of the capital allowances for those cases are shown in Figure 94.

Figure 94 Capital Allowances for Companies incurring Losses, 2007 and 2008

	Accounting Periods ending in			
	2007		2008	
	€m	€m	€m	€m
Trading Activities Taxed at Standard Rate				
Industrial Buildings	29		43	
Machinery and Plant	501		942	
Miscellaneous	<u>49</u>	579	<u>69</u>	1,054
Trading Activities Taxed at 10% Rate				
Industrial Buildings	4		22	
Machinery and Plant	33		131	
Miscellaneous	1	38	1	154
Total		617		1,208

17.22 As these companies already had a trading loss in the period, the allowances will have the effect of augmenting the trading losses of those companies for the relevant accounting periods. They will increase the amount of losses available for carry forward to future accounting periods, to the extent that the losses are not

- offset against other trading profits, if any, of the same accounting period
- offset on a value basis against other profits of that accounting period
- carried back against profits of the preceding accounting period, or
- surrendered for group relief purposes.

Income Tax Loss Relief

17.23 Total Income Tax trading losses used in 2008 were €35 million. In addition, relief for trading losses of €557 million was not obtained in 2008 and these are available for carry forward to future years. Unused rental losses carried forward to 2008 from earlier periods for those liable to Self-Assessed Income Tax totalled €1.7 billion in 2008.

Views of the Accounting Officer

17.24 Revenue has commenced internal discussions to establish how best their processing systems for Corporation Tax can be adapted to produce aggregate data on the amount of losses used and carried forward by companies. In considering any enhancements, the competing demands for resources for other systems developments have to be borne in mind.

17.25 Revenue pays particular attention to the monitoring of losses in the very largest corporate groups and financial services companies dealt with in their Large Cases Division. Any exceptional potential tax impacts arising from losses in these cases – insofar as they can be determined from all available information, including discussions between Revenue and the groups – are taken into consideration as part of the forecasting process.

Conclusion

In the case of companies, the available figures indicate a growing trend in losses available for carry forward and this is likely to have increased further in 2009. Trading losses alone increased in 2008 by €3 billion to €17 billion and trading losses carried forward from earlier periods increased by €6 billion to €12 billion between 2007 and 2008. Available information for rental losses, losses on disposal of capital assets and unused capital allowances for companies recording a loss suggests that the aggregate amount of these losses being carried forward may exceed €2 billion.

While it is accepted that the impact of the loss overhang on future collection is difficult to forecast, it constitutes a material and growing potential tax offset that calls for further analysis and categorisation designed to model the predicted effect on revenue taking account of the financial positions of the major companies that account for the potential future claims.

In order to do this, Revenue would need to adapt its information systems to identify the losses that are used in a period and the extent to which they are carried forward to offset profits of subsequent periods or lost through non-claiming or discontinuance.