Possibilities in uncertain times

The Covid-19 pandemic has resulted in the unusual spectre of the Government providing financial assistance to a large swathe of Irish businesses in order to keep their lights on. Whilst this period of Governmental generosity is viewed as an economic necessity, a large part of the cost of this financial assistance may ultimately have to be paid for by those same businesses and their staff in the form of future tax increases. One would have thought that the economy will require significant stimulation in the short term and it is therefore unlikely that there will be wide-ranging tax increases, indeed it is far more likely that VAT reductions are sought across many sectors to boost activity. The sacred cow of Irish taxation, the 12.5% corporation tax rate, will not be increased – as arguably to do so would be detrimental to the FDI sector.

So, where to then for the Minister of Finance in his efforts to balance the books? Experience from the last recession suggests that the majority of tax raising measures will be sought via the income tax system, most likely by way of increases in rates or reductions in

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In this article Mark and Amanda explore the possibilities for mitigating future increased tax burdens

allowances and credits. The rate of capital taxes, capital gains tax (CGT) and capital acquisitions tax (CAT) was increased to 33% during the last recession and remains at that level today, there may be little scope for increased tax take here especially when the already high rates are coupled with undeniable collapsing asset values. The rate of stamp duty on commercial property is already penal at 7.5% and there is unlikely to be much further scope for tax raising under that head.

For family businesses and their owners that suffer financial loss over the coming months, what are some of the options available to them to reduce the impending future tax burdens?

Loss relief – trading losses

A detailed review of loss relief provisions is beyond the scope of this article. Practitioners who have not reviewed the area of loss relief in recent years should be aware that changes were made to the legislation to restrict certain losses of land dealing trades, certain losses of passive trades and the introduction of anti-avoidance provisions on certain loss schemes. Practitioners are also reminded that certain losses are subject to time limits for claims and that losses of non-active partners in a partnership can be subject to restrictions.

An individual may offset losses from a trade against, firstly, other income of the individual (e.g. rents, employment income) or against the income of their spouse or civil partner. An individual may then carry forward unutilised losses to future years to offset against profits of the same trade. It is not possible to offset trade losses carried forward against, say, rental income or employment income. A further restriction on losses forward is that they cannot be offset between spouses or civil partners.

There are specific provisions relating to losses arising from a farming trade. For instance, where a farmer incurs losses for three consecutive years, any losses arising in the fourth year can only be carried forward to offset against future profits of the same farming trade and cannot be offset against other income (with certain exceptions).

Terminal loss relief is available where a trade is permanently discontinued and the person carrying on the trade has incurred a loss. The relief allows a person to carry back the loss to the three preceding years of assessment, and receive a refund of tax paid on the profits in those periods to the extent that the losses allow.

Broadly, companies that incur losses can offset those losses against other profits of the company in the current accounting period, carry the losses back to the prior accounting period to offset profits of that period (if applicable), any unutilised losses may then be carried forward for offset against future profits of the company (with that offset only available against profits of the same trade). Companies that are a member of a group for corporation tax purposes can avail of group relief to offset trading profits against certain profits of other group members.

Capital losses

2020 will be an unusual year for taxpayers, many will have realised capital gains in the first few months of the year but may crystallise capital losses in the latter part of the year or still hold assets with latent losses at the year end. For individuals, CGT operates on a calendar year basis, so if an individual realises a capital gain during the year and crystallises a capital loss in the same year, the loss can be offset against the gain when computing the overall CGT position for the year. The CGT position of companies and CGT on development land is beyond the scope of this article and is not examined here.

Broadly, a loss is calculated in the same manner as a gain for CGT purposes. There are, however, some important differences, for example, indexation relief cannot be used to either create or increase a loss. If a gain on the disposal of an asset would not be chargeable (e.g. a fully qualifying principal private residence), then a loss arising on the disposal of that asset is not an allowable loss. In addition, where the person making the disposal is not domiciled in Ireland, any losses accruing to them on the disposal of assets situated outside Ireland are not allowable losses for CGT purposes whether the proceeds of sale are remitted into Ireland or not.

Unused CGT losses are carried forward and must be set off in the earliest possible year against any net gains of that year, and any unused balance carried forward to the next year and so on until all losses forward are used up. Except in the case of a CGT loss arising to an individual in the year of their death, relief cannot be given for a year of assessment earlier than the year of assessment in which the loss actually arose.

In the case of a married couple or civil partnership, surplus losses of one spouse or civil partner (either in the current period or carried forward) may be set against gains of the other spouse or civil partner.

Taxpayers may well be tempted to dispose of assets held at a loss before the year end to set off against capital gains, care should be taken in this regard, for example losses arising on disposals to connected parties are ring-fenced and certain losses that are crystallised on share portfolios can be ring-fenced by B&B share dealing rules.

Succession planning

The value of many family businesses have plummeted over the last few months, profits have fallen significantly and this has impacted on valuations. Current indicators are that certain commercial property values (e.g. hotels, pubs and restaurants) have also fallen quite significantly. Many families are using the opportunity presented by lower asset values to undertake succession planning and transfer the business to the next generation. The main taxes that arise on succession planning (CGT, CAT and stamp duty) are based on the current market value of the asset at the time of the relevant transfer. Transferring when the assets have a low value should result in reduced tax costs with any increase in value or profits after the transfer accruing to the successors.

Furthermore, the suite of tax reliefs that allow for tax efficient succession planning are effective and when managed correctly the tax burden on succession planning can be low. This is arguably the correct economic approach to succession planning as without tax efficient succession many family businesses may stagnate and ultimately fail with all the knock on consequences of a failed business. Nevertheless, a Government that is under pressure to raise tax revenues may seek to dilute some of these tax reliefs. This fear is prompting some family business to undertake their succession planning now while the reliefs are intact and a smooth transition can occur.

Propping up family companies

Many family held companies are now being propped up financially by their shareholders; often little thought is given as to how this financial assistance is provided with the typical method being by way of a shareholders loan. Such a loan can be quickly made and is often informal in nature, if the company fails and the loan is lost there is no tax relief generally available. It is often suggested that the loan should be converted into share capital such that when the company is liquidated the shareholder would realise an allowable loss for CGT purposes. In many cases such a scheme is likely to fail by reason of a specific anti avoidance provision on the issue of shares which, in the case of an insolvent company, is likely to determine the base cost of the shares allotted on the conversion of the loan as nil.

Some consideration should be given to documenting the making of the loan and including in the terms of the loan rights that are likely to make the loan a 'debt on security', e.g. the loan should be convertible to shares, capable of increasing in value, marketable, etc. If a loss were realised on a debt on security it may be possible to offset the loss against certain capital gains. In this way the shareholder could at least attempt to gain some relief for their loss.

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