Averaging of Farm Profits

Part 23-01-34

This document should be read in conjunction with section 657 of the Taxes Consolidation Act 1997.

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Introduction

This manual outlines the income averaging regime provided for under section 657 of the Taxes Consolidation Act 1997 ('TCA 1997') which allows farmers to pay tax on the averaged profit and losses of their farming trade over a period of 5 years. This scheme is intended to assist farmers dealing with the income volatility associated with the farming industry by providing a mechanism to even out taxable income over a number of years. Prior to 31 December 2014, averaging was calculated over 3 years. With effect from 1 January 2015, the period over which income can be averaged was extended to 5 years.

1. Eligibility

Income averaging treatment is available to all individual farmers, farming solely or in partnership. Prior to 1 January 2019, farmers could not avail of income averaging in the following circumstances:

- where a farmer, or the farmer's spouse/civil partner, carried on another trade or profession unless that trade or profession related to on-farm diversification conducted on the farmland; or
- where a farmer, or a farmer's spouse/civil partner, was a director of a company carrying on a trade or profession and that farmer, or that farmer's spouse/civil partner, was the beneficial owner or was able to control, either directly or indirectly, more than 25% of the ordinary share capital of the company.

Finance Act 2018 removed these restrictions with effect from 1 January 2019.

A farmer must elect in writing, within 30 days of the date of an assessment, to participate in the averaging regime. An election for averaging can only be made where the farmer has been charged to tax under section 65(1) TCA 1997 in respect of farming profits for each of the 4 immediately preceding years of assessment in which the election is made. This means that an individual is not entitled to make an election for income averaging for a tax year if a tax loss was incurred in any of the four preceding tax years and no tax was charged in respect of any profits for any of the four preceding years[1]. Capital allowances and relief for losses carried forward are given as a set off against taxable profits. Therefore, in circumstances where the taxable profits are reduced to nil by capital allowances or losses carried forward, an election for averaging may still be made. In commencement situations, the first two years are charged to tax under section 66 TCA 1997, therefore a newly commenced farming business would be in year 7 before becoming eligible to make an election.

[1] If averaging over three years the two preceding years were taken into consideration.

2. Tax treatment under averaging

From 1 January 2015 the period of averaging is 5 years. The farmer is charged to tax on the average of the aggregate farming profits and losses (before deduction of capital allowances or inclusion of balancing charges which are not subject to averaging) of the tax year in which the election is made and the 4 tax years immediately preceding that year[2]. If the aggregate for the five years after deducting any losses is a net profit, one fifth of that profit is the amount assessable for the relevant tax year. If a net loss is made over the entire averaging period, the assessable amount is nil for that year.

Once the election is made, the farmer continues to be assessed on the averaging basis for subsequent years, assuming all qualifying conditions continue to be met. The minimum duration of averaging is 5 years after which the farmer can revert to the normal basis of assessment by giving a notice to this effect with the return of income for the year in question. With effect from the 2016 tax year, there is a facility to temporarily step-out of the averaging regime once every five years, see Section 6 and Section 7 in respect of the temporary additional option in respect of 2020.

Where a farmer's profits are charged using income averaging, capital allowances, balancing allowances and balancing charges are dealt with as they would have been if the normal, current year basis applied, that is, on the basis of expenditure incurred in the particular year. Any capital allowances to be granted and/or any balancing charges to be made are deducted from or added to the averaged profits, as the case may be, in arriving at the farmer's taxable profits for the year.

Losses are deducted from the aggregate of profits in the averaged period. Where the loss exceeds profits, one fifth of the loss is attributed to the relevant tax year. Relief may be claimed for this amount (one fifth loss), under the normal loss relief rules[3], e.g. under section 381 TCA 1997 against the individual's income from all sources for that year or under section 382 TCA 1997 against the individual's farming income in the next tax year (and later years). Loss relief does not apply to the remaining four fifths of the aggregate loss. In the case of a farmer who first elected to average in 2014, where in any year a loss is in excess of the profits, one quarter of that amount will be treated as a loss sustained in the trade of farming for the final year of the 4 years.

[2] Under longstanding Revenue practice, PRSI and USC may also be calculated on the average profit.

[3] Refer to Tax and Duty Manual Part 12-01-02 for more detail on income tax loss relief

Example 1 Averaging commenced in 2021

Year of Assessment	Profit/loss in year of assessment	Aggregate for year of assessment and 4 previous years	Average profit for assessment before capital allowances (1/5 of Col 3)
2017	15,000		
2018	18,000		
2019	21,000		
2020	24,000		
2021	30,000	108,000	21,600
2022	(21,000)[4]	72,000	14,400
2023	33,000	87,000	17,400

3. Reversion to normal basis of assessment

The minimum duration of averaging is 5 years after which the farmer can revert to the normal basis of assessment by giving notice to this effect with the return of income for the year in question. The normal (current year) rules apply to the assessment for the year of reversion and subsequent tax years. The 4 years prior to the final year of averaging are reviewed to ensure that the amount charged in those years is not less than that charged for the final year of averaging. If necessary, an additional assessment is made so the amount of profit for the reviewed years is increased to the profits of the final year of averaging.[5]

4. Deemed opt out prior to 1 January 2019

Prior to 1 January 2019, where an individual ceased to qualify for averaging because they (or their spouse/civil partner) commenced to carry on another trade or they (or their spouse/civil partner) became a director of a company which carried on a trade, and they owned or were able to control, directly or indirectly, more than 25% of the ordinary share capital of the company, they were deemed to have opted out of averaging. In such circumstances they were taxed on the normal basis for the deemed opting out year and subsequent tax years. Whether or not the first four of the five preceding years were averaged, a review was carried out to ensure that the final amount assessed was not less than the income averaged assessment for the last years of averaging.

[4] As the farmer has incurred a loss in 2021, they may choose to elect to temporarily opt out of averaging in that year. Section 6 refers.

[5] Special measures are provided for those farmers who opted out of averaging in 2015 and 2016.

Example 2 Effect of deemed reversion in 2017 where averaging commenced 2014

	Profits €	Averaged profits €	Increased to €
2012	12,000		17,380
2013	12,400		17,380
2014 averaged over three years	13,000	12,467	17,380
2015 averaged over four years	14,000	12,850	17,380
2016 averaged over five years	35,500	17,380	
2017 (cessation) normal basis	30,000		

The assessment for the year of deemed reversion was made on the actual profit i.e. €30,000. As the amounts previously assessed for each of the years 2012 to 2015 were less than the €17,380 averaged profit for 2016, the assessments for each of the four years were increased to €17,380. The profits earned in the 5 years to 2016 were €86,900 [12,000 + 12,400 +13,000 + 14,000 + 35,500] and the profits assessed for the same period was likewise €86,900 [17,380 x 5].

5. Re-electing for income averaging (after reverting to normal basis)

An individual who has opted out of the averaging regime may subsequently re-elect for income averaging, but only after his/her farming profits have been assessed on the normal basis under section 65(1) TCA 1997 for at least four years before re-electing.

6. Option for temporary step-out of averaging

With effect from the 2016 year of assessment and subsequent years, farmers may avail of an option to step-out of the income averaging regime for a single year. This allows farmers to pay tax based on the actual profits of the particular year as opposed to the average amount that would normally be due. The resulting deferred tax will be payable in instalments over the following 4 years. An individual shall only be entitled to make an election to opt out of averaging once every 5 years[6]. Any outstanding deferred tax becomes due and payable immediately if a farmer elects or is deemed to have elected to opt out of averaging permanently.

[6] With the exception of the temporary Covid-19 relief measures introduced for the year of assessment 2020, set out in Section 7.

Example 3 Temporary opt out in 2016

Year	Averaged Profit	Actual Profit	Income Tax on Average Profit[7] A	Income Tax on Actual Profit B	Deferred Tax A - B	Instalment (A-B /4) Payable over 4 years	Income Tax Due
2012		€37,000					
2013		€34,000					
2014[8]	€36,000	€37,000					
2015[9]	€37,000	€40,000					
2016[10]	€30,700	€ 5,500	€6,140	€1,100	€5,040		€1,100
2017	€24,900	€ 8,000	€4,980			€1,260	€6,240
2018	€20,100	€10,000	€4,020			€1,260	€5,280
2019	€18,700	€30,000	€3,740			€1,260	€5,000
2020	€17,700	€35,000	€3,540			€1,260	€4,800

7. Additional option to temporarily step out of averaging (Covid-19 measure)

To provide relief for farmers who are adversely impacted by the Covid-19 restrictions, an additional option to step-out of averaging is provided for the year of assessment 2020. This option is available to farmers who have already used their option to temporarily step out of the regime.

To avail of this additional step-out option, the following conditions must be satisfied:

- the farmer must have availed of the option to temporarily step out of the averaging regime in one of the 4 preceding years of assessment, and
- the farmer must have sustained a loss in the period 1 January 2020 to 31 December 2020.

As with the opt-out described, under Section 6, an election is made in the Form 11 tax return, payment of the tax that would otherwise be due under averaging is deferred and it is payable in equal instalments over 4 years. Instalments will be payable in addition to any deferred tax instalments that are payable following the previous opt-out.

Where such an election is made, the farmer may not elect to step out of averaging for a further 5 years.

[7] Assuming farmer pays tax at the standard rate.
[8] First elected for averaging in 2014, averaging calculated over 3 years.
[9] Special measure for farmers who first elected to average in 2014, 2015 calculated over 4 years.
[10] Averaged over 5 years from 1 January 2015.

If a farmer elects out of averaging permanently, any outstanding deferred tax will become due and payable immediately.

Example 4 Covid-19 step-out

Pat Murphy availed of the option to step-out of the income averaging regime in 2018, due the impact of the fodder crisis on his profits. The adverse impact of the Covid-19 pandemic resulted in a loss in the 2020 year of assessment. Pat chooses to step-out of averaging again for 2020.

2020 – pre step-out election

Income tax payable on Pat's averaged profits for 2020 would be €4,900 and the instalment of tax deferred from the 2018 step-out is €845. His assessable profits for 2020 would therefore be €5,745.

2020 – step-out election

For 2020, Pat will carry out the step-out calculation as set out in Example 3.

After making that election, instead of being taxed on the averaged profits from the years 2016 to 2020, he pays no tax on his 2020 loss (which as set out in section 2 above can be used for normal income tax loss reliefs) but continues to pay the tax in relation to the 2018 deferral of €845.

The Covid-19 deferred tax of €4,900 to be paid in equal instalments of €1,225 over 4 years, starting in 2021 year of assessment and the immediately following 3-years.

2021

In the 2021 year of assessment the tax on Pat's averaged profits and losses for the years 2017 to 2021 is €4,880, the deferred tax instalment from the 2018 step out is €845 and the first instalment of the Covid-19 deferred tax is €1,225. Pat's assessable profit is €6,950.

8. Permanent Cessation

Where a farming trade permanently ceases the cessation rules of section 67 TCA 1997 (basis on discontinuance of a trade or profession) operate even where an election has been made for averaging (section 657(10) TCA 1997). Consequently, the assessable profits for the year in which the cessation occurs will be the actual profits of that year as opposed to the averaged profits. A penultimate year review should also be carried out.

Example 5 Effect of cessation on review of penultimate year

A farmer, with an accounting year end of 31 December, permanently ceases his farming trade on 30/06/2021. The profits to be charged for the year in which the trade is permanently discontinued are the actual profits earned in the period from 1 January and ending on the date of cessation i.e. €3,000 in the example below. The assessment for 2020 (the year preceding the year of the cessation) must be reviewed.

	Actual Profits €	Average Profits €
12 months to 31/12/2016	12,000	
12 months to 31/12/2017	(2,400)	
12 months to 31/12/2018	2,000	
12 months to 31/12/2019	15,000	
12 months to 31/12/2020	5,500	6,420
6 months to 30/06/2021 (cessation)	3,000	

Under the cessation rules, the assessable profits in the penultimate year are the higher of the taxable profit computed under averaging (€6,420) and the actual profit for the year from 1/1/2020 to 31/12/2020 (€5,500). As the actual profit does not exceed the profit calculated under averaging, the assessable profit remains the averaged profit for 2020.

Where a spouse/civil partner takes over the entire farming trade on the death of his or her spouse/civil partner, the usual cessation and commencement provisions do not apply. Instead, the spouse/civil partner who takes over is regarded as continuing the farming activities of the deceased spouse/civil partner and the averaging of profits may also continue without any need for revision.

9. Registered Farm Partnerships and Averaging

In circumstances where the cessation of a sole trade of farming is due to the commencement of a Registered Farm Partnership (RFP) under section 667C TCA 1997, the partnership is treated as a continuation of the sole trade, but only for the purposes of the income averaging provisions (section 657(10A) TCA 1997). This means that there is no discontinuance of the trade which would cause averaging to cease, however the cessation rules in section 67 TCA 1997 must be applied in the normal manner to the sole trade. This will cause a review of the final years of the sole trade. The profit calculated under the cessation rules will be included in the averaging calculation for the purpose of calculating the assessable profit under income averaging in the year of cessation. The same principle applies to the commencement provisions which are applied by section 655(2) TCA 1997 i.e. the commencement rules apply to the RFP but income averaging can continue.

Example 6 Cessation of sole trade and start of partnership

- Farmer A is on income averaging and makes accounts up to 31 December each year. They cease the farming sole trade on 30/06/2021 and commence a Registered Farm Partnership on 01/07/2021. The same figures as in Example 5 above are being used.

- The profits of the trade for the 5 years ending on 31/12/2020 were as follows: 31/12/2016 = €12,000, 31/12/2017 = (€2,400), 31/12/2018 = €2,000, 31/12/2019 = €15,000 and 31/12/2020 = €5,500.
- Sole trade ceases on 30/06/2021 and under the cessation rules, the profits in 2021 are actual profits from 01/01/21 to 30/06/21 = €3,000.
- Penultimate year assessable amount is higher of taxable profits under averaging (€6,420) and actual profits from 1/1/20 to 31/12/20 (€5,500). Therefore, Farmer A remains taxable on the original amount calculated under averaging.
- On commencement of the partnership on 01/07/2021, Farmer A is taxable on the profits from the date the several trade commenced to the following 31 December. The partnership makes up its accounts to 30 June and Farmer A's share of the partnership profit is €10,000 for the 12 month period to 30/06/2022. Profit under commencement rules is €10,000 x 6/12 = €5,000.
- For 2022, under the commencement rules Farmer A is taxable on the profits for the 12 month period from the date the several trade commenced = €10,000.
- For 2023, Farmer A is taxable on the profits to 30/06/2023 say, €6,000.
- Necessary to calculate 2nd year excess for 2022:
    - Profits taxable - €10,000
    - Actual profits - €8,000
    - 2nd year excess - €2,000.
- Taxable profit for 2023 is €6,000 - €2,000 = €4,000.

The below table illustrates the continuation of averaging based on the resultant profit from applying the cessation/commencement rules.

	Profits **€**	**Assessable profits under continued averaging** **€**
12 months to 31/12/2016	12,000	
12 months to 31/12/2017	(2,400)	
12 months to 31/12/2018	2,000	
12 months to 31/12/2019	15,000	
12 months to 31/12/2020	5,500	6,420
6 months to 30/06/2021 (cessation) 6 months to 31/12/2021 (commencement)	3,000 5,000 8,000	5,620
12 months to 30/06/2022 (commencement)	10,000	8,100
12 months to 30/06/2023 (commencement)	4,000	8,500