

Debt Release – Land Dealers and Developers.

This document should be read in conjunction with section 87B of the Taxes Consolidation Act 1997

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1. Introduction

1.1. Section 18 of the Finance Act 2013 introduced a new section 87B into the Taxes Consolidation Act 1997. This new section makes provision for the release of a debt, in certain circumstances, to be treated as a receipt of income and, consequently, chargeable to tax. The circumstances are as follows:

- It applies **only** to individuals who are engaged in the trade of dealing in or developing land.
- It applies **only** to the release of certain debts, being loans used to purchase land or property, which is held as trading stock.

The essential aim of the section is to ensure that individuals engaged in the trade of dealing in and developing land do not obtain the benefit of losses for tax purposes when they have not, in fact, incurred any economic loss.

The section is of no relevance in situations where other business or personal debts are written off.

1.2. The provision deals only with debts incurred in respect of borrowed money used to purchase or develop land which is held as trading stock. Generally, this will involve funds advanced by financial institutions rather than debts owed to other trade creditors. For income tax purposes (the provision does not apply to companies) the amount of the debt which is released is treated as a receipt of income in the year in which it is released. It is chargeable under Case I or Case IV of Schedule D, depending on whether the trade is still ongoing or has ceased. For the purposes of computing the amount of the tax liability, other losses of the trade which had been carried forward up to that point may be off-set against the deemed income receipt. Depending on the amount of losses carried forward, there may be little or no tax actually payable in respect of the debt released.

2. Released Debts

2.1. The most obvious reason why a debt, or part of a debt, might be released is because the borrower cannot repay it and, due to a decline in the value of the property held as security, the bank, which holds the security, cannot recoup the full amount owing from the proceeds of sale of the security. This may also happen in the context of personal insolvency or bankruptcy. A second reason why a loan might not be repaid is that it was limited recourse or non-recourse. This means that the debtor's obligation to the bank is limited to the value of the land/property over which the bank has security. In such circumstances, the bank has no option but to write off part of the debt since that is a condition of the loan agreement itself.

- 2.2. The key issue is that where land and property are held as trading stock (and this will be so in the case of a property dealing/development trade) the value of that land and property will already be written down in the taxpayer's books (the lower of cost or net realisable value) to reflect its decline in value. These write-downs are deductible for tax purposes. Up until the introduction of section 87B, this deduction was allowable even though the trader might not have, in fact, incurred an economic loss. This could happen where the trader borrowed on non-recourse terms. Any fall in the value of the land would be matched by the write off of an equivalent amount of the loan. The new section 87B of the Taxes Consolidation Act 1997, inserted by section 18 of the Finance Act 2013, addresses this anomaly by treating the amount released as a receipt of income.
- 2.3. The following examples illustrate the way in which the provision is intended to operate:

Example 1

In this example, the trader's loss in the trade of dealing in and developing land is solely attributable to the write down in the value of the land which has been purchased with borrowed money. The trader has no other income. The land has declined in value by 150 over the period of ownership and this amount is released by the lending institution in Year 4.

	Year 1	Year 2	Year 3	Year 4
Income	100	100	100	100
Expenses	(100)	(100)	(100)	(100)
Land W/D	(50)	(50)	(50)	-
87B Income	-	-	-	150
Profit/Loss	(50)	(50)	(50)	150
Losses B/F	-	(50)	(100)	(150)

The losses carried forward from Years 1, 2 and 3 are set against the profit for tax purposes in Year 4 resulting in no tax being paid. The trader has not suffered an economic loss on the purchase and sale of the land and the effect of section 87B is to ensure that no tax loss can be carried forward beyond Year 4 in respect of the sale.

Example 2

The facts are the same as in Example 1 except that the write-down in land value in years 1, 2 and 3 has the effect of reducing profit rather than creating a loss in those years and the loan is a non-recourse loan which is paid off in Year 4 out of the proceeds of sale of the land, with the result that the trader pays the bank 150 less than the amount borrowed.

	Year 1	Year 2	Year 3	Year 4
Income	200	200	200	100
Expenses	(100)	(100)	(100)	(100)
Land W/D	(50)	(50)	(50)	-
87B Income	-	-	-	150
Profit/Loss	50	50	50	150
Losses B/F	-	-	-	-

The trader has obtained the benefit of the write-down over years 1 to 3. There are no losses, therefore, available in Year 4 to set against the section 87B income, which is fully chargeable to tax. The trader has not suffered an economic loss on the purchase and sale of the land. The effect of section 87B is that the previous advantage enjoyed by the trader is removed by assessing an amount equal to the amount of the "loss" already claimed.

Example 3

In this example, the facts are as in Example 1 except that the taxpayer is in receipt of Case II income during Years 1, 2 and 3. Loss relief is available in each of those years in respect of the trading losses.

	Year 1	Year 2	Year 3	Year 4
Income	100	100	100	100
Expenses	(100)	(100)	(100)	(100)
Land W/D	(50)	(50)	(50)	-
87B Income	-	-	-	150
Profit/Loss	(50)	(50)	(50)	150
Case II Income	50	50	50	-
Loss Relief	(50)	(50)	(50)	-
Losses B/F	-	-	-	-
Taxable Income	-	-	-	150

The trader has obtained the benefit of the write-down over years 1 to 3 by way of set off against Case II income. There are no losses, therefore, available in Year 4 to set against the section 87B income, which is fully chargeable to tax. The trader has not suffered an economic loss on the purchase and sale of the land. The effect of section 87B is that the previous advantage enjoyed by the trader is removed by assessing an amount equal to the amount of the "loss" already set off against Case II income.

2.4 Other restrictions to the loss relief provisions for land dealers and developers (a new section 381A), which were also introduced in section 18 of the Finance Act 2013 will mean that, in the future, it is less likely that a net charge to tax will arise due to the application of section 87B. This is because section 381A restricts loss relief to circumstances where land value losses are actually realised. In effect, the realisation of the loss and the creation of the income receipt under section 87B will happen virtually simultaneously, with each cancelling the other out.

3. When is Debt Released?

3.1 The following 4 scenarios of debt release are addressed in the legislation:

- when the lender formally confirms to the borrower that the debt has been released,
- when an agreement or understanding has been reached between borrower and lender, even in the absence of a formal confirmation, that the debt is no longer required to be repaid,
- when, in the case of a limited recourse or non-recourse loan, the excess of the loan amount over the amount realised on the sale of the land or property is automatically released.
- when the release of debt results from bankruptcy or personal insolvency.

4. Bankruptcy and Personal Insolvency

- 4.1. While the time at which a debt is released is relatively clear in the first 3 scenarios, some clarification may be needed in the case of bankruptcy and personal insolvency.
- 4.2. In bankruptcy, the Bankruptcy Act 1988 requires that all debts owed to creditors at the time of adjudication of bankruptcy must be proven to the Official Assignee and that creditors have no remedy against the debtor or his/her property except through the bankruptcy process. Section 87B specifies that the date of release is the date of discharge from bankruptcy. In practice, Revenue will not object to the date of final distribution being taken as the date of release, where this falls after the date of discharge.
- 4.3. It is important to note that, in accordance with section 76 of the Bankruptcy Act 1988, only pre-adjudication debts can be claims in bankruptcy. The time of adjudication is the time when the person is declared bankrupt. This rule applies to all debts, including tax debts owing to the Revenue Commissioners. Tax liabilities which arise on or after the time of adjudication are not claims which can be proven in bankruptcy. The bankrupt's estate is administered by the Official Assignee for the benefit of the creditors but only as respects pre-adjudication debts. This means that tax debts arising as a result of the

application of section 87B are not claims which can be proven in bankruptcy because they arise post-adjudication.

- 4.4. Under normal circumstances it would be unusual for a bankrupt to accumulate further debts during the bankruptcy process post–adjudication. This is because of the general financial constraints under which he/she is placed by the rules of bankruptcy. For example, normal lines of credit would not typically be available to him/her. Tax debts are an exception to this general rule. The Revenue Commissioners can be placed in the position of involuntary creditor both during and after the bankruptcy process where, for example, the bankrupt has continued to trade and incurred tax debts.
- 4.5. In personal insolvency, the date of debt release is the date on which all the requirements of the Personal Insolvency Arrangement or Debt Settlement Arrangement have been satisfied by the debtor and he/she stands discharged from the debts specified in the arrangement.

5. Computation of Tax Charge

- 5.1. If the trade of land dealing/developing is ongoing when the debt is released, then the deemed income receipt is treated as a trading receipt at that date. If, however, the trade has been discontinued by the time the debt is released, then the receipt is chargeable under Case IV of Schedule D, but is computed as if it were chargeable under Case I for the year of assessment. This means that normal Case I deductions and losses forward are allowed before the tax charge applies.

6. Payment of Tax

- 6.1. In the specific circumstances set out in the new section 87B, the income tax charge on the amount of debt forgiven is simply a clawback of relief previously given. If that relief has not previously been used to reduce other tax liabilities, then it is available to reduce any charge to income tax arising from the debt release itself. It is only where the taxpayer has used those earlier deductions and losses to shield other income from tax that any net charge to income tax will arise as a result of the debt release. The tax charge is treated in the same way as any other and it is the responsibility of the taxpayer to make whatever tax payments are appropriate.
- 6.2. In the context of bankruptcy, any tax liability which may arise under section 87B is not a pre-adjudication debt. The Official Assignee has no responsibility for post-adjudication debts of the bankrupt, except in his administration of bankruptcy assets, both pre-adjudication (assets which vest automatically in the OA) and post-adjudication (assets over which the OA may claim control) claimed assets. Where a debtor continues to earn income during the period of bankruptcy the OA has a responsibility to ensure that the debtor has sufficient

funds to discharge any tax liabilities which arise in respect of that income. That responsibility of the OA continues up to the date of discharge from bankruptcy or the time at which a final distribution of assets is made to the creditors, if later. Because the release of the debt, which arises as a result of section 87B, occurs on the later of the date of discharge or final distribution of assets, Revenue accepts that the OA has no responsibility to provide for or account for any resulting tax liabilities, even though the debt release itself is a direct consequence of the bankruptcy process.

- 6.3. The responsibility for paying any tax liabilities arising under section 87B rests solely with the taxpayer. As indicated earlier, in many instances no additional income tax liability will arise because of the existence of losses forward. Where a liability does arise and a taxpayer has difficulties with regard to payment, there may be a necessity to discuss appropriate payment arrangements with the Office of the Collector-General.
- 6.4. A broadly similar position applies in the case of personal insolvency. Section 100 of the Finance Act 2013 amended sections 65 and 99 of the Personal Insolvency Act 2012 by requiring any Debt Settlement Arrangement or a Personal Insolvency Arrangement to make provision for the payment of all tax liabilities which arise during the administration of either arrangement.
- 6.5. Revenue accepts that any tax liability resulting from the application of section 87B arises on the date of discharge from insolvency. Consequently, any resulting tax liability is the responsibility of the taxpayer and no provision for its payment need be made as part of the administration of either arrangement by the Personal Insolvency Practitioner. As in the case of bankruptcy, it may be necessary for the taxpayer to discuss appropriate payment arrangements with the Office of the Collector-General.

7. Capital Gains Tax.

- 7.1. Section 42 of the Finance (No.2) Act 2013 introduced a new subsection (1B) into section 552 of the Taxes Consolidation Act 1997. This subsection provides that, where a debt incurred in relation to borrowed monies used to acquire or enhance an asset is not repaid and the borrower is released in respect of some or all of the debt, the amount so released will not be allowed as a deduction in computing a chargeable gain or loss on a later disposal of the asset. For the purposes of section 552, the time of debt release is determined in the same way as for section 87B. Full details are contained at **19.02.10A**.