

## **Income tax loss relief**

### **Restrictions to the amount of relief available**

#### **Part 12-01-02**

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## 1. Introduction

There are a number of sections which are relevant when determining what relief an individual can obtain for losses that arise in the course of a trade. This manual sets out the sections which provide for the relief and also details the sections that restrict that relief.

The interaction of the provisions dealing with loss relief and the provisions dealing with determining the assessable profits in situations of commencement/cessation/change in accounting date are not dealt with in this manual.

## 2. What relief is available for trading losses?

### 2.1 Current year trading losses (section 381)

When an individual is carrying on a trade or a profession and that individual incurs a loss for a year of assessment, then relief may be available under **section 381 TCA 1997**. That section provides that an individual may elect to have the trading/professional loss offset sideways against other income of the individual, or in cases of joint assessment, against income of the individual's spouse/civil partner.

**Section 392 TCA 1997** provides that an individual may treat the current year trading/professional capital allowances as an amount to be deducted in computing the profits or loss of that trade/profession for the purposes of making a claim for relief under **section 381**. If the **section 381** loss (as augmented or created by the **section 392** election) exceeds the individual's other income, the **section 381** relief is treated as having been given first in respect of the tax loss of the trade in priority to the capital allowances (thereby leaving the capital allowances not set off under the claim to be carried forward to the following tax year).

### 2.2 Carry forward of unused trading losses (section 382)

**Section 382 TCA 1997** provides that a loss in respect of which relief is not given under **section 381** is carried forward and set against the next available profits of the trade or profession (note that this does not include any capital allowances treated as a loss under **section 392**).

For this purpose, the profits of the trade or profession of the next year available to cover the loss carried forward, are the taxable profits for that year after deducting the capital allowances. If those profits (after capital allowances) are insufficient to fully absorb the tax loss carried forward, the balance is again carried forward to the following year of assessment, and so on, until the loss is fully used up.

### 2.3 Terminal loss relief (section 385)

Terminal loss relief is dealt with in Tax and Duty Manual [Part 12-05-06](#).

### 3. How relief is given under section 381

Where in a year of assessment an individual sustains a loss in a trade or profession (whether carried on solely or in partnership with others), that individual can choose to make a claim for relief under **section 381**.

The loss available for the claim is the amount computed under the rules of Schedule D Case I or Case II, in the same way as the taxable profits would be computed, before deducting any capital allowances. However, a claim may be made under **section 392** to have the loss increased by the amount of capital allowances less any balancing charges.

If a taxpayer chooses to claim relief under **section 381** then he cannot choose to use only part of the loss against part of his income. Instead, if a claim for relief is made, the full loss must, in so far as possible, be set off against all of the taxpayer's income. Equally, if that individual is jointly assessed, then he/she cannot choose to claim relief against his/her income, but not against his/her spouse's/civil partner's income. Losses in excess of the individual's other income must first be offset against trading income of his/her spouse/civil partner with any remaining excess offset against the other income of his/her spouse/civil partner.

**Section 381(6)** provides that an individual may make a claim for loss relief under the section not later than 2 years after the end of the year of assessment to which the claim relates. Any claim for a repayment of tax under **section 865** arising out of, for example, an error or mistake in the original tax return, would therefore need to be made within that same two-year timeframe<sup>1</sup>.

### 4. Claiming relief under section 381

Once the amount of the **section 381** loss to be claimed has been determined, relief under **section 381** is given on a repayment basis by re-computing the taxpayer's liability to income tax for the year of claim. In this regard, **section 381(5)(b)** provides that relief for the losses is regarded as a deduction in computing total income. The revised income tax liability is compared with that calculated before the **section 381** relief claim and any excess tax paid is refunded to the taxpayer.

**Section 381(6)** provides that any claim for repayment of tax must be made in the appropriate form within 2 years of the year of assessment in which the loss was sustained. The claim for relief can be made on the Form 11 or Form 12 as appropriate by entering the amount of the loss to be set off against other income. Claims may also be submitted electronically via ROS Form 11 and eForm 12. Although a **section 381** claim is technically one of a repayment of income tax previously assessed, if a valid claim is submitted on the Form 11/Form 12 for the relevant year in which the loss is sustained, the final self-assessment on the income may be reduced by the amount of the loss claim thus negating the need to seek an amended assessment.

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<sup>1</sup> Refer to Tax and Duty Manual (TDM) [Part 37-00-30](#) for more details on claims for repayments or offsets of tax.

It should also be borne in mind that the tax loss is the amount resulting from the computation for the period **before** any capital allowances or balancing charges are taken into account (subject to the making of a **section 392** claim). However, in determining whether an individual is a 'chargeable person' for self-assessment purposes, the amount of the individual's non-PAYE income, for the purpose of applying the €5,000 threshold, is the amount **after** taking a deduction for capital allowance.

## 5. Restrictions on relief available under section 381

There are a number of restrictions on how much relief an individual can claim under **section 381**. The main restrictions are dealt with below.

### 5.1 Land losses (section 381A)<sup>2</sup>

**Section 18, Finance Act 2013** introduced certain restrictions on the ability of part-time property developers to claim loss relief under **section 381** in certain circumstances.

#### 5.1.1 Definitions

##### (i) Specified loss

For the purpose of the restriction a "specified loss", in relation to a year of assessment means a loss sustained in the course of a "specified trade" which relates to:

- a deduction taken for interest on debt incurred to finance the purchase or development of land held as trading stock, and/or
- a deduction taken for the write-down in value of such land.

##### (ii) Specified trade

A "specified trade" means a trade of dealing in or developing land, or any activity that is regarded to be as such under **section 640(2)(a)**, to which the rules of Chapter 1 of Part 22 of the Taxes Consolidation Act 1997 apply.

##### (iii) Specified trader

The restriction will apply to individuals who are taxed as dealers in or developers in land, but who are engaged in that trade on a non-active basis. A "specified trader" is defined as meaning an individual whose income from the specified trade in relation to any particular tax year and the preceding two tax years is less than 50% of the individual's aggregate income for the same period.

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<sup>2</sup> Applies in respect of interest becoming payable or a reduction in the value of land held as trading stock occurring on or after 13 February 2013.

(iv) Restriction

A claim for loss relief under **section 381** by a specified trader is restricted where the loss is a specified loss and the specified loss has arisen:

- as a result of a deduction for interest which has not been paid prior to the **section 381** claim being made, and/or
- due to the write-down of the value of land held as trading stock where there has been no disposal of the land prior to the claim being made.

For example, where a loss arises in the course of dealing in or developing land in the 2016 year of assessment, and a portion of the loss relates to a deduction taken for interest which was accrued for but not paid, a valid **section 381** claim in respect of the 2016 year of assessment can not be made unless the interest is paid by 31 December 2018.

Similarly, the impairment of land held as trading stock in accordance with standard accounting principles cannot form part of a valid **section 381** loss relief claim unless the land is disposed of to an unconnected party. **Section 381A(3)** excludes any disposals of the land to 'connected persons' within the meaning of **section 10**.

The amount of such losses which are disallowed for the purposes of the relief claim under **section 381A**, will still be available to carry forward against any future profits arising from the same trade under **section 382**.

## 5.2 Non-active trades (section 381B)<sup>3</sup>

Loss relief is restricted in respect of losses incurred by individuals in trades which are essentially hobby or passive trades.

### 5.2.1 Definitions

#### (i) Trade

For the purposes of this restriction the term 'trade' does not include:

- Farming or market gardening (as these are dealt with under paragraph 5.5)
- Lloyd's underwriting business (as this is a deemed trade rather than an actual trade).

<sup>3</sup> Applies for the 2015 year of assessment and subsequent years of assessment.

**(ii) Loss**

For the purpose of this restriction, a loss includes any amount of capital allowances which are to be treated as a loss by virtue of **section 392**. However, it does not include any loss created through the use of capital allowances to which the property relief surcharge applies<sup>4</sup>.

A loss will also not include an amount deemed to be a trading loss under **section 482** (relief for expenditure on significant buildings and gardens).

**(iii) Non-active capacity**

A person does not work for the greater part of his or her time on the day to day management or conduct of the trade during a period unless:

- Over the course of that period the person spends an average of at least 10 hours a week personally engaged in the activities of the trade or profession, and
- Those activities are carried out on a commercial basis, and
- in such a way that profits of the trade or profession could reasonably be expected to be made in that period or within a reasonable time afterwards.

Activities which are not undertaken in a commercial manner with a view to the realisation of profits e.g. reading the newspapers or emails, will not count towards the 10 hour minimum test. There must at least be a realistic prospect that the activity undertaken will result in an enhancement to the trade (for example, an increase in income, a reduction in costs or attracting additional customers or suppliers). Simply carrying out some activity that is related to the trade may not be sufficient.

Activities undertaken in start-up trades which generate losses in the initial years while the business is being built up and/or in trades which encounter unexpected market conditions due to circumstances outside their control, (for example economic downturn, increasing interest rates etc.), will not be excluded provided the activities are being conducted in a manner which is conducive to the generation of profits and a reasonable expectation exists that a profit will be turned in the future. However a trade which is virtually certain to lead to a loss

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<sup>4</sup> See TDM [Part 18D-00-01](#) for more details on this.

cannot be said to be carried out on a commercial basis and is more likely to be carried on as a hobby.

**(iv) The restriction**

An individual who carries on a trade in a non-active capacity during a year of assessment is subject to a cap on the amount of loss relief that can be claimed under **section 381**. The cap, which applies regardless of how many 'non-active trades' are being carried on, is €31,750 per year of assessment.

If the basis period for a year of assessment is shorter than 12 months, then the limit is reduced proportionately.

Any amount in excess of the limit can be carried forward for use against the profits of the same trade in future years.

5.2.2 Case law

In the UK case of Eoghan Flanagan & Christopher David Moyles & Allan Stennett v HMRC [2014] UKFTT 175, the First-Tier Tribunal held that a tax avoidance scheme designed to manufacture trading losses did not work on the basis that the scheme users were not carrying on a second-hand car dealership trade in their spare time as claimed. The FTT determined that:

**“none of the appellants took any interest whatever in the details of the purchases and sales, that they were indifferent to whether a profit or loss was made, and that they obtained the bare minimum of information solely in order that that information could be entered on their tax returns.”**

The FTT therefore held that from the perspective of the scheme users, the scheme did not involve a trade carried on with a view to a profit, but was a means of securing tax relief.

**“I am satisfied that none of the appellants was trading in the proper sense of that word, but that they were instead engaged in an arrangement designed only to give the illusion of trading, and that the appeals must be dismissed on that ground alone.”**

Another UK case of Acornwood LLP and others v HMRC [2014] UKFTT 416 (TC), examined the tax position of a number of UK partnerships and their members in relation to arrangements entered into for the purpose triggering large losses on the acquisition and exploitation of intellectual property rights. The First-Tier Tribunal, in examining whether the members were entitled to sideways loss relief, held that none of the members were 'active' members in the partnership. The FTT held that:

**“the individual referrers spent the time because they had been told they must, and that they undertook activities such as they described, not in the expectation or even hope that**



**anything useful might come of them, either for that reason alone or, because they happened to enjoy the particular activity for its own sake, as a pleasurable means of fulfilling a statutory requirement”.**

The tribunal concluded “...that the research activities not only did not advance the trade of any partnership, but had no realistic prospect of ever doing so.”

### 5.2.3 Exceptions

There may be circumstances in which an individual could temporarily become a non-active trader due to, for example, illness or maternity. The 10 hour a week test is an average test which must be met over the course of a year. So for an on-going trade, an individual must spend, on average 10 hours a week for 52 weeks a year, or 520 hours in total for a year engaged in the trade. This is around 30% of the hours a full time employee would work in a year. Therefore, it is anticipated that it is only in very limited circumstances that an individual, who had been working in a full time trade and who will resume work in that trade in the future, will fail to meet that test for a given year. However, in exceptional or unique circumstances Revenue may determine whether, based on the facts and circumstances of that particular case, the loss relief should be restricted.

## 5.3 Tax avoidance arrangements (section 381C)<sup>5</sup>

Loss relief is restricted in circumstances where the loss arises from a tax avoidance transaction, the purpose of which was to create such a loss to reduce the amount of tax payable on other income in a year.

### 5.3.1 Definitions

Unlike **section 381B** there is no specific restriction to the word ‘trade’ in this section. The restriction provided for under this section therefore covers any trade for which a person could seek to claim loss relief under **section 381**.

#### (i) Arrangements

For the purposes of this restriction, an arrangement includes an agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).

#### (ii) Loss

For the purpose of this restriction, a loss includes any amount of capital allowances which are to be treated as a loss by virtue of **section 392**. However, it does not include any loss created

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<sup>5</sup> Applies for basis periods for a year of assessment where that basis period commences after 23 October 2014.

through the use of capital allowances to which the property relief surcharge applies<sup>6</sup>.

A loss will also not include an amount deemed to be a trading loss under **section 482** (relief for expenditure on significant buildings and gardens).

**(iii) Non-active capacity**

A person does not work for the greater part of his or her time on the day to day management or conduct of the trade during a period unless:

- Over the course of the basis period for the year of assessment, or a period of 6 months – whichever is the longer, the person spends an average of at least 10 hours a week personally engaged in the activities of the trade or profession, and
- Those activities are carried out on a commercial basis, and
- In such a way that profits of the trade or profession could reasonably be expected to be made in that period or within a reasonable time afterwards.

In cessation cases, the period of 6 months is the 6 months up to the date of cessation. In all other cases it is a period of 6 months starting on the first day of the basis period.

**Examples of 6 month period:**

John has been trading for many years. He ceased to trade on 31 March 2016. For the 2016 year of assessment, John's basis period is the account profits/losses from 1 January 2016 to 31 March 2016. The period of 6 months is the 6 month period ending on 31 March 2016.

Joan has been trading for a number of years and will continue to trade for the foreseeable future. She changed her year end, and for the 2016 year of assessment, Joan's basis period is her accounts from 1 November 2015 to 31 March 2016. The period of 6 months is the 6 month period starting on 1 November 2015.

Jo commenced her trade on 1 January 2016 and ceased the trade on 31 January 2016. For the 2016 year of assessment, Jo's basis period is her accounts from 1 January 2016 to 31 January 2016. The period of 6 months is the 6 month period ending on 31 January 2016.

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<sup>6</sup> See TDM [Part 37-00-30](#) for more details on this.

Mark prepares 12 month accounts from 1 January 2016 to 31 December 2016. As the basis period for the year of assessment is longer than 6 months, the basis period itself is used.

**Examples of 10 hours a week on average:**

John must have worked 10 hours a week, on average for a period of six months to cessation. John's final basis period is 3 months. Therefore, this 6 month period covers a longer period than his final basis period.

Jo must have worked 10 hours a week, on average, for a period of six months. ( $10 * 4 * 6 = 240$  hours). As she was only trading for one month, she must, in effect, work 240 hours in that one month period in order to avoid failing this test.

Mark must work 10 hours a week, on average, for the 12 month period.

5.3.2 The restriction

An individual may not claim any relief under **section 381** in respect of a loss sustained in a trade, which was

- (a) carried on in a non-active capacity, and
- (b) where the loss arises in whole or in part, directly or indirectly, in consequence of or otherwise in connection with arrangements, the main purpose, or one of the main purposes of which, was to give rise to a claim under **section 381**.

The restriction will not apply to genuine loss-makers who have not entered into avoidance arrangements. To decide whether the main purpose, or one of the main purposes, of arrangements is to obtain relief for losses, it is necessary to look at all the circumstances in which the arrangements were entered into, including the participant's overall economic objective. If the loss arises in connection with a marketed tax avoidance scheme, it is most likely that the restriction will apply, however the legislation is by no means restricted to such instances.

5.3.3 Case law

In *Eclipse Film Partners No. 35 v HMRC* [2015] EWCA Civ 95 (17 February 2015), a partnership entered into a complex series of financial transactions to enable its partners to obtain tax relief on their income. The First-Tier Tribunal, the Upper Tribunal and the Court of Appeal unanimously found that the scheme did not work and rejected the partnership's claim that it had made trading losses on the basis that it had not been 'trading'. In the Court of Appeal, Sir Terence Etherton held that the appellant partnership had not

discharged **“the evidential burden of showing that it was engaged in trade in any realistic or meaningful way”**.

In the Acornwood case<sup>7</sup>, the First-Tier Tribunal in ruling that the scheme was a tax avoidance arrangement held that:

**“We are quite satisfied that he knew that profits, in the true sense, were unlikely and that, absent a tax advantage, this was not a prudent investment since he was much more likely than not to lose the money paid in from his own resources. We are also satisfied that his primary motive for joining the partnership was to secure sideways relief; no other plausible conclusion is possible. In so far as his evidence was to the contrary, we reject it.”**

#### 5.3.4 Exceptions

See 5.2.3 above in relation to temporary non-active traders.

### 5.4 Capital allowances (section 409A - 409E)

Section 30, Finance Act 1998 introduced a restriction on the amount of relief available for tax losses arising from certain property based tax incentives.

Where an individual is entitled to claim capital allowances under certain property reliefs, such as industrial buildings or hotels, this amendment restricts the loss relief available by virtue of a claim under section 392. It provides that in general an individual can only claim relief for €31,750 of the losses created from using capital allowances against his or her other income.

### 5.5 Farming losses (section 662)<sup>8</sup>

There are two possible situations in which the relief available under **section 381** can be restricted in the case of losses from farming or market gardening.

#### 5.5.1 Non-commercial losses (section 662(2)(a))

No relief is available under **section 381** unless the farmer/market gardener can show that the loss was incurred in a year when the trade was carried out on a commercial basis and with a view to the realisation of profits.

#### 5.5.2 3 years of losses (section 662(2)(b))

In addition to and independently of the commercial test, loss relief is not allowed if losses have been incurred in each of the 3 preceding years (unless the trade was commenced within prior 3 years). Exceptionally, this restriction will not be applied where the claimant proves that the farming/market gardening activities have a justifiable expectation of generating a profit in the future, notwithstanding that losses have been incurred in the prior 3 years.

<sup>7</sup> Acornwood LLP and others v HMRC [2014] UKFTT 416 (TC)

<sup>8</sup> Brought in by section 27 Finance Act 1974

## 5.6 Partnerships (section 1013)

This section ring fences the use of losses, capital allowances and charges by passive partners against the profits assessable in relation to that several trade.

A passive partner is someone who does not work for the greater part of his or her time on the day to day management or conduct of the partnership trade.

## 5.7 Pre-trading expenditure (section 82)

Pre-trading expenses which are deductible under **section 82(3)** are not permitted to create or augment a claim for a loss under **section 381**.

A more recent version of this manual is available.