Restriction on the allowance of capital losses (S.546A)

Part 19-02-05A

This document should be read together with section 546A TCA 1997

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Revenue
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Introduction

Section 546A of the Taxes Consolidation Act 1997 (“TCA 1997”) provides for the restriction on the allowance of capital losses introduced by section 59 Finance Act 2010. It sets out the scope of the provision and how Revenue envisages its application.

Various schemes, which attempted to generate artificial capital losses for offset against real chargeable gains, have been identified. Countering provisions have been introduced aimed at particular types of scheme. These identified arrangements have largely been an attempt to reduce individuals’ chargeable gains by artificial losses. They have involved companies, but the primary aim was to assist individuals in reducing their Capital Gains Tax (“CGT”) liability. These arrangements will continue to receive the attention of section 811/811A/811C TCA 1997.

The new provision applies to both CGT and to the chargeable gains of companies.

5A.1 Arrangements and tax advantage

The structure of the section is to deny a capital loss, if it arises by virtue of arrangements and the main purpose, or one of the main purposes of the arrangements is to secure a tax advantage. Both ‘arrangements’ and ‘tax advantage’ are widely defined –

‘**arrangements**’ includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable);

‘**tax advantage’** means –

(a) relief or increased relief from tax,

(b) repayment or increased repayment of tax,

(c) the avoidance or reduction of a charge to tax or an assessment to tax, or

(d) the avoidance of a possible assessment to tax.

It is Revenue’s intention that capital losses will be unavailable where it is a reasonable inference from the facts that arrangements are in place with the primary intention of deriving a tax advantage. The schemes mentioned at paragraph two above undoubtedly, in Revenue’s view, fall into this category.

5A.2 Genuine commercial transactions

Section 546A will not apply where there is a genuine commercial transaction that gives rise to a real commercial loss as a result of a real commercial disposal. In these circumstances there will be no arrangements with a main purpose of securing a tax advantage. Conversely, where there is either no genuine commercial disposal, or no real commercial loss, or no real commercial disposal or any combination of the

foregoing then there are likely to be arrangements in place with a main purpose, or one of the main purposes, of securing a tax advantage so the legislation will apply.

The term ‘arrangement’ includes any agreement, understanding, scheme, transaction or series of transactions, whether or not legally enforceable. Whether a transaction forms part of a series of transactions, or a scheme, or arrangement is in general a question of fact, but this conclusion will follow in any case where one transaction would not have taken place without another transaction, or would have taken place on different terms without that other transaction. However, it is not necessary that transactions must depend on each other in this way in order that they form part of a scheme or arrangements.

If a tax advantage arises out of a transaction that is part of the arrangements, the legislation asks whether the main purpose or one of the main purposes of the arrangements is to achieve a tax advantage. The purpose of the arrangements is determined by the purpose of the participants in entering into the arrangements. If any participant has a main purpose of achieving a tax advantage, that will constitute a main purpose of the arrangements.

5A.3 Factors that determine a tax advantage

There is no one factor that determines whether the obtaining of a tax advantage is a main purpose of an arrangement. All of the circumstances in which the arrangements were entered into need to be taken into consideration. Such circumstances might include:

- the overall commercial objective (this should be considered from the perspective of not only the individual participants but also from any wider corporate group to which they belong – for these purposes a commercial objective does not include tax motivated reasons);
- whether this objective is one which the parties involved might ordinarily be expected to have, and which is genuinely being sought;
- whether the objective is being fulfilled in a straightforward way; or
- whether the introduction of any additional complex or costly steps would have taken place were it not for the tax advantage that could be obtained.

If a subsidiary has suffered a capital loss, this may affect the value of other group companies higher up the group chain. If the loss of the subsidiary is allowable, then any consequential loss of another company will also be allowable, and vice versa.

Example 1

An individual enters into transactions which produce a gain which is not chargeable because of an existing relief or exemption. Other transactions are undertaken which produce an allowable loss. Either one or both sets of transactions have no

commercial or economic purpose. It is clear that one or both were entered into in order to secure a tax advantage. Resulting losses are not allowable.

Example 2

An individual enters into a series of transactions involving companies. The market value rules of section 549 TCA 1997 have the effect of producing a loss for the individual. Apart from this purpose, the series of transactions has no discernible economic or commercial aim. The loss is not allowable.

Example 3

Companies A, B and C are members of a CGT group. A acquires an asset for €200m. This is later transferred to B for €100m, which is its then market value. There is a further deterioration in value and C acquires the asset from B for €75m, also its value at time of acquisition by C. C sells the asset at arm’s length to a third party outside the group for €75m. By virtue of section 617 TCA 1997, neither A nor B has a chargeable gain and C has a loss of €125m. Although C has no economic loss itself (it bought and sold for €75m), the loss of €125m is not denied, assuming there was a reasonable commercial purpose in the sale by it.

Example 4

A group of companies is a group for CGT purposes. A disposal of a member, Company A, outside the CGT group would give rise to a capital loss. However, the group wishes to retain the company. It arranges for the formation of a new subsidiary, Company B, which is technically outside the CGT group. A loss arising on a disposal of A to B is not allowable because an arrangement was in place, the main purpose of which was to gain a tax advantage. If it could be convincingly shown the arrangement was for good commercial purpose, then the loss might be allowable.

Example 5

The facts are as in example 4, but the group arranges the disposal of A to a third party, perhaps a bank, with an agreement that it be bought back within a short period. The main purpose of the disposal is to gain a tax advantage and the loss is not allowable.

Example 6

Group company A acquired an asset from a fellow member, Company C, under the no gain/no loss rule of section 617 TCA 1997. The original cost to C was €10m and it was acquired by A when its value was €8m. Arrangements are made to issue shares in A to a third party so that A is no longer technically a member of the CGT group. The new shares have restricted rights only, as compared with the original shares in A. The €2m loss arising in A when it leaves the group (section 623 TCA 1997) is not allowable because the main purpose of the share issue was to gain a tax advantage.

If it could be demonstrated that the share issue to the outside party was for genuine commercial reasons the result might be otherwise.

Example 7

The liquidation of a group member which has suffered a genuine commercial loss would not generally invoke the provisions of section 546A TCA 1997, even if there is a gain available for set-off.

Example 8

Availing of the negligible value provisions of section 538 TCA 1997 will not be affected by this provision.