

Averaging of Farm Profits

Part 23-01-34

Document last updated January 2019.

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Introduction

This manual outlines the income averaging regime provided for under section 657 of the Taxes Consolidation Act 1997 (TCA) 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 that farmer was not entitled to elect for income averaging, unless that trade or profession related to on-farm diversification conducted on the farmland. In addition, a farmer could not elect for averaging if the farmer, or the farmer's spouse/civil partner, was a director of a company carrying on a trade or profession and the farmer, or the 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.

An election for averaging can only be made where the farmer has been charged to tax under section 65(1) TCA in respect of farming profits for each of the 4 immediately preceding years of assessment in which the election is made. A farmer must elect in writing, within 30 days of the date of an assessment to participate in the averaging regime. The legislation requires that the individual 'was charged' to tax in accordance with section 65(1) TCA for the requisite preceding years. Therefore, 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 years¹. 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, 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 year². 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 5.

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 then 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, e.g. under section 381 TCA against the individual's income from all sources for that year or under section 382 TCA 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 then 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.

Example 1. Averaging commenced in 2015

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)
2011	15,000		
2012	18,000		
2013	21,000		
2014	24,000		
2015	30,000	108,000	21,600
2016	(21,000) ³	72,000	14,400
2017	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.⁴

³ As the farmer has incurred a loss in 2016, he/she may choose to elect to temporarily opt out of averaging in that year. Section 5 refers.

⁴ Special measures are provided for those farmers who elected to opt out of averaging in 2015 and 2016.

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.

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 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 years⁵. An individual shall only be entitled to make an election to opt out of averaging once every 5 years. 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.

Example 3. Temporary opt out in 2016

Year	Averaged Profit	Actual Profit	Income Tax on Average Profit ⁶ 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 ⁷	€36,000	€37,000					
2015 ⁸	€37,000	€40,000					
2016 ⁹	€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

⁵ Only income tax may be deferred. The farmer remains liable to PRSI and USC on the average profit, if using this basis to calculate the USC/PRSI.

⁶ Assuming farmer pays tax at the standard rate.

⁷ First elected for averaging in 2014, averaging calculated over 3 years

⁸ Special measure for farmers who first elected to average in 2014, 2015 calculated over 4 years

⁹ Averaged over 5 years

7. Permanent Cessation

Where a farming trade permanently ceases the cessation rules of section 67 TCA (basis on discontinuance of a trade or profession) operate even where an election has been made for averaging (section 657(10) TCA). 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 4. Effect of cessation on review of penultimate year

A farmer, with an accounting year end of 31 December, permanently ceases his farming trade on 30/06/2017. 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 2016 (the year preceding the year of the cessation) must be reviewed.

	Actual Profits €	Average Profits €
12 months to 31/12/2012	12,000	
12 months to 31/12/2013	(2,400)	
12 months to 31/12/2014	2,000	
12 months to 31/12/2015	15,000	
12 months to 31/12/2016	5,500	6,420
6 months to 30/06/2017 (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 1/1/2016 to 31/12/2016 (€5,500). As the actual profit does not exceed the profit calculated under averaging, the assessable profit remains the averaged profit for 2016.

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.

8. 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, 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). This means that there is no discontinuance of the trade which would cause averaging to cease, however the cessation rules in section 67 TCA 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 then 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 i.e. the commencement rules apply to the RFP but income averaging can continue.

Example 5. Cessation of sole trade and start of partnership

- Farmer A is on income averaging. He makes his accounts up to 31 December each year but ceases his farming sole trade on 30/06/2017 and commences a Registered Farm Partnership on 01/07/2017. The same figures as in Example 4 are being used.
- The profits of the trade for the 5 years ending on 31/12/2016 were as follows: 31/12/2012 = €12,000, 31/12/2013 = (€2,400), 31/12/2014 = €2,000, 31/12/2015 = €15,000 and 31/12/2016 = €5,500.
- Sole trade ceases on 30/06/2017 and under the cessation rules, the profits in **2017** are actual profits from 1 Jan to 30 June = **€3,000**
- Penultimate year assessable amount is higher of taxable profits under averaging (€6,420) and actual profits from 1/1/16 to 31/12/16 (€5,500). Therefore Farmer A remains taxable on the original amount calculated under averaging.
- On commencement of the partnership on 01/07/2017, Farmer A is taxable on the profits from the date the several trade commenced to the following 31 December. Say the partnership makes up its accounts to 30 June and Mr A's share of the partnership profit is €10,000 for the 12 month period to 30/06/2018. Profit under commencement rules is €10,000 x 6/12 = **€5,000**.
- For **2018**, 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 **2019**, Farmer A is taxable on the profits to 30/06/2019 say, **€6,000**.
- Necessary to calculate 2nd year excess for 2018:
 - Profits taxable - €10,000
 - Actual profits - €8,000
 - 2nd year excess - €2,000
- Taxable profit for **2019** 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 31/12/2012	12,000	
12 months to 31/12/2013	(2,400)	
12 months to 31/12/2014	2,000	
12 months to 31/12/2015	15,000	
12 months to 31/12/2016	5,500	6,420
6 months to 30/06/2017 (cessation)	3,000	5,620
6 months to 31/12/2017 (commencement)	5,000 = 8,000	
12 months to 30/06/2018 (commencement)	10,000	8,100
12 months to 30/06/2019 (commencement)	4,000	8,500