Tax relief for trading company losses - revisited

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Tax relief for trading company losses was covered by the Examiner in a detailed article of the same name in the 2004 Students' Newsletter.

In the buoyant "Celtic Tiger era" trading company losses may seem to be a less topical issue. It is however a very important area and loss relief questions can cause problems for candidates in examinations.

The purpose of this article is to both re-fresh and re-focus attention on this area. The reader should also refer to the article mentioned above for detailed examples.

S.396, TCA 1997 is the relieving section for losses incurred by a Company. Relief is given in two stages. The first stage S.396A reduces the profits to be taxed and the second stage S396B reduces the tax calculated on the profits remaining. The second stage reduction is done on a "value basis".

S.396A: - Relief is given **€ for €** against the loss arising**:**

STEP 1: Start in the year the loss was incurred. Schedule D Case I is usually NIL.

STEP 2: Carry back the loss against the Schedule D Case I income in an accounting period(s) of the **same length,** immediately preceding the accounting period where the loss arose.

S.396B: - Relief is given on a **value basis:**
The remaining loss is "valued" at the standard rate of tax prevailing in the year the loss arose. Credit is then given against the corporation tax that is calculated on the remaining profits, after relief has been given under S.396A above.

STEP 3: Credit loss **value** against the tax calculated on the remaining profits in the year the loss was incurred.

STEP 4: Credit loss **value** against the tax calculated on the remaining profits in the accounting period of the **same length** immediately preceding the accounting period where the loss arose.

If there is any loss still remaining to be used after the above 4 steps, the loss is carried forward and offset **€ for €**, against future Schedule D Case I income arising from the same trade.

Take note of the words ***accounting period of the same length.*** 'Same length' can usually encompass more than one period, as frequently happens in examination questions. It could also be just a portion of the previous period.

Example:

> *A trading loss of (€90,000) and rental income of €10,000 arose in the six month period ending 30th June 2006 The results of the previous year ending 31st December 2005 record a trading profit of €80,000 and rental income of €5,000.*

Solution:
It would be incorrect to reduce the profits of €80,000 to € nil. This is because the loss may only be carried back against an accounting period of the same length i.e. against six of the twelve months of the year ended 31st December 2005. Loss relief carried back is €80,000 x 6/12 = €40,000.

	Year ended 31/12/2005	**6 months ended 30/6/2006**
	€	**€**
Case I	80,000	nil
Case V	5,000	10,000
S396A x 6/12	(40,000)	
	45,000	

The tax on these remaining profits of €45,000 may yet stand to be relieved on the value basis, AFTER the value basis has been applied to the year where the loss arose:

The entire procedure is like the letter Z in reverse. Try drawing this " reversed Z" before continuing further i.e.

START HERE

Step 1 – period loss arises

Schedule D Case I
Step 2-corresponding period(s)

Step 3 – credit against tax

Step 4 – credit against tax

Now to continue the example:

		Year ended 31/12/2005	**6 months ended 30/6/2006**
		€	**€**
	Case I	80,000	nil- **Step 1**
	Case V	5,000	10,000
Step 2-	**S396A x 6/12**	(40,000)	
		45,000	

(Loss remaining €90,000 - €40,000 = €50,000)

Taxed:	**€**	**Taxed:**	**€**
Case I €40,000 @ 12.5% =	5,000	Case I	nil
Case V €5,000 @ 25% =	1,250	Case V €10,000 @ 25% =	2,500
	6,250		2,500
		Step 3- S.396B €20,000 @ 12.5%	(2,500)
		Due:	nil
		(Loss remaining €50,000 - €20,000 = €30,000)	
Step 4 - S.396B x 6/12	(3,125)*		
Tax due:	5,625		

* $€6{,}250 \times \frac{6}{12} = €3{,}125 \times \frac{100}{12.5} = €25{,}000.$

The remaining loss of €5,000 (€30,000 - €25,000) will be carried forward for offset against future Case I income arising from the same trade.

The effect of the strict application of the loss legislation results in Case I relieved further through application of relief under S.396B. Whilst not the intended spirit of the legislation it is an unforeseen consequence in the drafting of the legislation..

Finally, it is always an option open to the Company NOT to use up it’s loss valued at the standard rate by setting it against expensive other source income taxable at the higher rate. The Company may decide instead to carry the loss forward for offset against future Case I income.

Most questions will usually look for “maximum relief / at the earliest opportunity” indicating relief under both S.396A and S.396B is to be claimed. With the help of the drawing and the 4 step “reverse Z” approach used above, these questions should not pose a problem to the prepared student.