

corporation tax losses – part 1

relevant to new ACCA Qualification Paper F6 (IRL)

trading losses

■ This is the first of two articles on how losses incurred by a company can be used against profits in the current, previous, or future accounting periods. The focus of this article is on trading losses.

Trading losses are calculated using the same rules as for trading profits. Capital allowances are treated as a trade expense deductible in arriving at the Case I profit, and are therefore automatically included in the computation of losses. A company can use the following reliefs for its trading losses:

- **Section 396A of the Taxes Consolidation Act 1997**
A company can reduce trading income liable at the standard rate in the current accounting period. If there is any excess, it can be carried back to a previous period of corresponding length to reduce trading income liable at the standard rate.
- **Section 396B of the Taxes Consolidation Act 1997**
If there is any excess after Section 396A, Section 396B is available to reduce the company's total corporation tax liability on a value basis for the current period and, provided the company was carrying on the trade in the previous accounting period of corresponding length, against the corporation tax liability of that period.

CORRESPONDING LENGTH

Where a company carries a loss back to a previous period it must be of corresponding length. This means that if a company makes a loss in a 12-month period it can carry the loss back 12 months. However, if a company makes a loss in a nine-month period it can only be carried back nine months.

EXAMPLE 1

	Year end 31.12.06	Six months 30.6.07
Case I	€100,000	(€60,000)

The company carrying this loss back can only carry it back six months because the loss arose in a six-month period. The company would be able to reduce 6/12 of the Case I income of €100,000, ie €50,000.

TIME LIMIT

The time limit for any claim is two years from the end of the accounting period in which the loss arises.

SECTION 396(1)

If a company does not wish to reduce the current or previous period, or if they still have some loss remaining, the company must carry this loss forward under Section 396(1). They must reduce their next available trading profit from the same trade. As this section is not a choice open to a company there is no time limit. **Examples 2 and 3** explain these sections.

EXAMPLE 2

	Year ended 31.12.05	Year ended 31.12.06	Year ended 31.12.07
	€	€	€
Trade 1	20,000	25,000	30,000
Trade 2	80,000	(285,000)	150,000
Case V	20,000	22,500	25,000

Requirement

Calculate the company's corporation tax for all accounting periods, showing maximum use of the trading loss.

Solution

Step 1

Set out the corporation tax computations, claiming relief first against the company's trading income liable at the standard rate in the current and previous period (Section 396A).

Year ended 31.12.06

Case I	€
Trade 1	25,000
Trade 2	Nil
Case V	<u>22,500</u>
Income	47,500
Section 396A	<u>(25,000)</u>
	<u>22,500</u>

Corporation tax

€22,500 @ 25% = €5,625

Loss remaining

€285,000 - €25,000 = €260,000

Year ended 31.12.05

Case I	€
Trade 1	20,000
Trade 2	80,000
Case V	<u>20,000</u>
Income	120,000
Section 396A	<u>(100,000)</u>
	<u>20,000</u>

Corporation tax

€20,000 @ 25% = €5,000

Loss remaining

€260,000 - €100,000 = €160,000

Step 2

Use the excess trading loss to reduce the company's corporation tax on all profits in the current and previous period (Section 396B).

Year ended 31.12.06

Corporation tax	€	5,625
Loss relief		
€160,000 @ 12.5%	<u>(20,000)</u>	
	<u>Nil</u>	

Loss remaining

€20,000 - €5,625 = €14,375 / 0.125 = €115,000

Year ended 31.12.05

Corporation tax	€	5,000
Loss relief		
€115,000 @ 12.5%	<u>(14,375)</u>	
	<u>Nil</u>	

Loss remaining

€14,375 - €5,000 = €9,375 / 0.125 = €75,000

Time limit: 31.12.08

The remaining loss of €75,000 is carried forward under Section 396(1) to reduce profits of the same trade.

Year ended 31.12.07

Case I		€
Trade 1		30,000
Trade 2	150,000	
Less: Section 396(1)	<u>(75,000)</u>	75,000
Case V		<u>25,000</u>
Income		<u><u>130,000</u></u>

Corporation tax

€105,000 @ 12.5% = 13,125
 €25,000 @ 25% = 6,250
 €19,375

EXAMPLE 3

	Year ended 31.12.05	Six months 30.6.06	Year ended 30.6.07
	€	€	€
Case I	130,000	(70,000)	28,500
Case III	10,000	5,500	10,800
Gains – adjusted	5,000	6,500	-

Requirement

Calculate the company's corporation tax for all accounting periods, showing maximum use of the trading loss.

Solution

Step 1

Set out the corporation tax computations, claiming relief first against the company's trading income liable at the standard rate in the current and previous period (Section 396A).

Year ended 31.12.05

	€
Case I	130,000
Case III	10,000
Income	140,000
Gain	<u>5,000</u>
Profits	145,000
Section 396A	
€130,000 x 6/12 =	<u>(65,000)</u>
	<u><u>80,000</u></u>

Corporation tax

€65,000 @ 12.5% = 8,125
 €10,000 @ 25% = 2,500
 €5,000 @ 12.5% = 625
 €11,250

Loss remaining

€70,000 - €65,000 = €5,000

Step 2

Use the excess trading loss to reduce the company's corporation tax on all profits in the current and previous period (Section 396B).

Six months 30.6.06

	€
Case I	Nil
Case III	<u>5,500</u>
Income	5,500
Gain	<u>6,500</u>
Profits	<u><u>12,000</u></u>

Corporation tax

€5,500 @ 25% = 1,375
 €6,500 @ 12.5% = 813
 2,188
 Less: loss relief
 Section 396B
 €5,000 @ 12.5% = (625)
1,563

There is no loss remaining to carry back to the previous period.
 Time limit 30.6.08

Year ended 30.6.07

	€
Case I	28,500
Case III	<u>10,800</u>
Income	<u><u>39,300</u></u>

Corporation tax

€28,500 @ 12.5% = 3,563
 €10,800 @ 25% = 2,700
 €6,263

TERMINAL LOSS RELIEF

This area has been introduced into the Paper F6 syllabus with effect from December 2007. So far we have considered the use of a trade loss by a company in the current, previous, and future accounting period.

If a company has ceased trading, Section 396(1) will not be relevant as it only allows a company to carry a loss forward to reduce trading profits of the same trade. If a company has ceased trading and has insufficient

income in the current/previous period to absorb the loss, terminal loss will allow the company a measure of relief for the unused loss.

Terminal loss relief allows a company to use its trade loss in the last 12 months of trading to be carried back against income from the same trade in the three years preceding those last 12 months. Terminal loss relief will be given only where all other claims for loss relief have been made.

EXAMPLE 4

Dolan Ltd ceased trading on 31 December 2007. Its results for the four previous years were as follows:

	Year ended 31.12.04	Year ended 31.12.05	Year ended 31.12.06	Year ended 31.12.07
	€	€	€	€
Case I	25,000	15,000	8,000	(70,000)
Case V	5,000	5,000	5,000	5,000

You are required to show the use of the trade loss of €70,000.

Solution

Before terminal loss can be claimed, Dolan Ltd must claim relief for its trade loss under all other sections first.

Step 1

Year ended 31.12.2006

	€
Case I	8,000
Case V	<u>5,000</u>
Profits	13,000
Section 396A	<u>(8,000)</u>
	<u>5,000</u>

Corporation tax

€5,000 @ 25% = €1,250

Loss remaining

€70,000 - €8,000 = €62,000.

Step 2

Year ended 31.12.2007

	€
Case I	Nil
Case V	<u>5,000</u>
Profits	<u>5,000</u>

Corporation tax

	€
€5,000 @ 25% =	1,250
Less: loss relief Section 396B	
€62,000 @ 12.5% =	<u>7,750</u>
	<u>Nil</u>

Loss remaining

€7,750 - €1,250 = €6,500
€6,500 / 12.5 = €52,000

Year ended 31.12.2006

Corporation tax

	€
€5,000 @ 25% =	1,250
Less: loss relief Section 396B	
€52,000 @ 12.5% =	<u>6,500</u>
	<u>Nil</u>

Loss remaining

€6,500 - €1,250 = €5,250
€5,250 / 12.5 = €42,000

Dolan Ltd cannot carry this loss forward under Section 396(1) because it has ceased trading. To avail of relief for the loss remaining, the company must claim terminal loss relief under Section 397 of the Taxes Consolidation Act 1997. This section allows the company to carry the loss back three years to reduce profits of the same trade only. The company must start with the latest year first. The loss can only reduce the trading income. The loss is relieved as follows:

Year ended	Case I	Loss used	Balance
31.12.2006	Nil	Nil	€42,000
31.12.2005	€15,000	€15,000	€27,000
31.12.2004	€25,000	€25,000	€2,000*

* No relief can be claimed in respect of the balance of the unused loss.

The company will still have a corporation tax liability on its Case V income in 2005 and 2004, as terminal loss can only reduce trading income of the same trade.

CONCLUSION

This article concentrates on the use of a trading loss by a company. The second article will deal with the use of capital losses, Case V losses, and excess Case V capital allowances, and the tax consequences of a late return. ■

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