An Roinn Airgeadais
Department of Finance

Ms. Margaret Falsey
Committee Secretariat
Committee of Public Accounts
Leinster House
Dublin 2

30 April 2018

Ref: [PAC32-1-787]

Dear Margaret,

I refer to your letter of 17 April 2018.

During the course of the Committee on Public Accounts examination of the C&AG Report 2016 on Thursday 22 February 2018, the committee requested a note on 'whether consideration has been given to the imposing of a 'sunset clause' on the duration of the carry forward of losses relief and include international examples'.

1. Restriction of Corporate Losses

The issue of the restriction of 'Corporate Losses' (including the possibility of a 'Sunset Clause') was considered by The Department of Finance's Tax Strategy Group (TSG) in 2011.

Specifically, the 2011 Corporation Tax TSG paper included the following:

2.4 Corporate Losses – Impact on CT Yield

'Ireland provides tax relief for trading losses incurred by companies which is a standard feature of CT regimes in all OECD countries. Losses in one accounting period can be carried back for offset against profits of the immediately preceding accounting period, generating a tax refund. A three year carry-back of losses incurred in the last 12 months of trading applies in the case of a termination of trade. Losses can be carried forward indefinitely for offset against income of the same trade arising in future accounting periods. Group companies can use losses in the accounting period in which they arise.

The economic environment in which Irish businesses currently operate mean that a large number of companies are not generating enough profits for a tax liability to arise. This is reflected in the CT yield which has been falling in recent years and may not recover for some time to come.

Corporate losses have increased significantly in all OECD countries as a result of the economic crisis. In Ireland, the biggest losses have been incurred in the banking, construction and property-related sectors. The significant increase in corporate losses will have an impact on CT receipts in the years ahead but it is not possible to estimate the full extent of this, as the use of loss relief will depend on the capacity of companies with accumulated losses to generate sufficient profits to absorb such losses. This will vary from sector to sector and it is likely that some companies will not be able to utilise much of their losses because of insufficient profits or the cessation of their business. While the domestic banking sector (now largely loss-making) was in the past a major contributor to corporation tax, a very

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significant proportion of CT yield continues to come from a relatively small number of consistently profitable companies, mainly multinationals - the yield from these companies will be unaffected by losses.

Apart from affecting corporation tax yield, the significant increase in corporate losses arising from the recent financial and economic crisis poses tax compliance risks which will need to be monitored. While there are various restrictions under existing legislation to counter the transfer of losses from one company to another, it will be necessary to remain vigilant to any aggressive tax planning schemes that may emerge which seek to circumvent existing restrictions on the use of losses.

Some possible options for restricting the amount of losses a company may claim include:

- *Applying a percentage limit to the amount of Case I trading profits which may be offset by various forms of trading losses eg losses forward, losses on a value basis, group relief, one year carry-back and terminal loss relief. This will retain a proportion of a company's trading income within the charge to tax each year.*
- *Applying a similar limit to profits otherwise offset by Case IV (miscellaneous) losses, Case V (rental income) losses and excess capital allowances and capital losses.*

It should be noted that the potential yield from a limit on the amount of profits in any year that may be relieved by losses will depend critically on the quantum of profits available to absorb such losses.

Provisions already exist in the case of banking institutions participating in the NAMA process under which only 50% of such institutions' taxable trading income in any year can be sheltered by losses carried forward by those institutions. There are, however, very particular circumstances applying in the case of the NAMA-participating banks. [1]

Loss relief is a standard feature of corporation tax regimes in OECD countries and changing our rules now may give out a negative signal about the stability and predictability of our CT regime. The provision of loss relief recognises that a business cycle runs over several years and that it would be unbalanced to tax profits in one year and not allow losses in another.

A restriction of loss relief could jeopardise the viability of fragile, loss-making businesses as they seek to return to profitability. Companies will argue that they have contributed significant tax revenue when they were profitable and now that they have incurred losses in the recession we change the rules without notice.

Restricting group relief would favour companies with branch structures rather than subsidiaries. Therefore a restriction of this provision may not be appropriate or effective'.

2. International Comparison

With regard to international comparisons, Committee members may wish to note an OECD report, published in 2011, which conducted a comparison of the treatment of Corporate Losses in a number of OECD member states. A comparison table is attached at Appendix 1 and the full report can be found on the OECD website at the following link:

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[1] **(50% restriction removed in Finance Act 2014)**

http://www.oecd.org/publications/corporate-loss-utilisation-through-aggressive-tax-planning-9789264119222-en.htm

3. Recent UK Corporate Loss Changes

The UK has recently introduced restrictions on the total amount of losses that can be utilised against profits for accounting periods from 1 April 2017.

These restrictions apply to carried-forward trading losses as follows:

- The overall amount of profit that can be relieved using most types of carried-forward losses - including carried-forward trading losses incurred either before or after 1 April 2017 - is restricted to the amount of an allowance up to £5 million, plus 50% of remaining total profits after deduction of the allowance.[2]

The above restrictions on the use of losses in a particular accounting period do not change the right to claim the losses indefinitely.

4. Report on the effect of limiting tax relief on losses

Committee members may be aware that, during the Committee Stage of the Finance Bill 2017, the Minister for Finance agreed that officials of this office would produce a report on the effect of limiting tax reliefs on losses carried forward for banks. It is intended that the imposition of a sunset clause will be considered in this report and comparison will be made with the approach taken to losses by other administrations. In view of the complexities of this issue, it was agreed this report would be submitted to the FinPer Committee in June 2018.

The progress of the report and the intended delivery date was the subject of a written PQ on 8 March 2018 from Deputy Michael McGrath [11543/18] and was also the subject of a priority question on 27 March 2018 from Deputy Pearse Doherty [14034/18].

Yours sincerely

Derek Moran
Secretary General

[2] https://www.gov.uk/guidance/corporation-tax-calculating-and-claiming-a-loss

Carry-over of losses

There are two types of carry-over rules: carry-back and carry-forward.

Loss carry-forward is provided in all the participating countries, while loss carry-back is only allowed in some countries. Certain countries provide for quantitative limitations on the deduction of losses carried back or forward.

A summary of the main features of country rules on loss carry-overs is included in the table below.

Country	Loss carry-back	Loss carry-forward	Restrictions	Exceptions	Rulings
Australia	No	Indefinite	Change of ownership and activity	Ownership tracing concessions apply to widely held companies	Yes
Austria	No	Indefinite[1]	Change of ownership and activity	Other (non-tax) considerations	No
Canada	3 years	20 years	Change of ownership and activity	Acquisition of corporations business activities[2]	No
Denmark	No	Indefinite	Change of ownership and other criteria[3]	Internal reorganisations	No
France	3 years	Indefinite	Change of activity	No	Yes
Germany[4]	1 year	Indefinite	Change of ownership	Other (non-tax) considerations	No
Ireland	1 year[5]	Indefinite	Change of ownership and activity	Internal reorganisations	No
Italy	No	5 years[6]	Change of ownership and activity, mergers	Other (non-tax) considerations	Yes, in some cases
Mexico	No	10 years	Change of ownership and activity,[7] mergers[8]	Inheritance, donation, internal reorganisation, merger and split off that are not considered alienations for tax purposes[9]	No
Netherlands	1 year[10]	9 years	Change of ownership and activity[11]	Lack of tax avoidance motive	Yes
New Zealand	No	Indefinite	Change of ownership	Ownership tracing concessions Internal reorganisations[12]	No
Norway[13]	No[14]	Indefinite	Change of ownership and other criteria	Lack of tax avoidance motive	Yes
Spain	No	15 years[15]	Change of ownership[16]	Internal reorganisations	No
Sweden	No	Indefinite	Change of ownership[17]	Internal reorganisations	Yes, in some cases
Switzerland	No[18]	7 years	Change of ownership and restart of activity	Financial Restructurings	No
United Kingdom	1 year[19]	Indefinite (against profits of the same trade)	Change of ownership and activity	Internal reorganisations	No
United States	2 years[20]	20 years	Change of ownership	No	No

1. A loss carry-forward can only offset 75% of income.

2. Losses of a corporation generally may be carried forward and back as permitted by the Act. However, to restrict abuses, "stop loss rules" were introduced to prohibit the transfer of losses by a corporation in certain circumstances. These rules generally apply in circumstances where there is a change of ownership and also in the acquired corporation's business activities.

3. These rules do not apply to financial enterprises, including banks.

4. Monetary restrictions apply to the carry-back and to the carry-forward of losses.

5. If a trade is permanently discontinued the loss may be carried-back against profits of the same trade for the previous 3 years.

6. Losses which occur in the first 3 years from the beginning of the business activity can be carried forward indefinitely.