



High-Earner Restriction – Carried-Forward Reliefs

Marie Bradley and Nora Walsh *PricewaterhouseCoopers*

Introduction

Finance Act 2006 contains most of the legislation governing the operation of the restriction on reliefs claimed by certain high earners, and Cáit Monagher explained how these restrictions operate in her article in the July 2007 edition of *Irish Tax Review*.

Certain aspects of the new regime were “tidied up” in Finance Act 2007. One such aspect is the treatment of tax reliefs carried forward by an individual at 1 January 2007, as the new regime first takes effect for the 2007 tax year. In this article we focus on this aspect of the new regime and the consequential impact that the reliefs brought forward have on the computation of taxable income.

Schedule 25C

The relevant legislation can be found in Schedule 25C of the Taxes Consolidation Act 1997. Schedule 25C sets out the rules to be applied in determining the amount of the reliefs carried forward which are deemed to be “specified reliefs” for the purposes of calculating the restriction, if any, applying to the individual for the 2007 tax year.

The requirement to apportion reliefs carried forward applies only to those carried forward under ss304, 382, 305 and 384 TCA 1997.

Each formula operates by apportioning the relief carried forward by reference to the ratio of specified reliefs (SR) to total reliefs (TR) of that category arising in the tax years 2003 to 2006 inclusive. Only reliefs actually available in

each of those years are included in the SR and TR calculations, i.e., relief carried forward from years prior to 2003 is ignored.

Schedule 25C is broken down into four parts: the first two parts deal with reliefs claimed by an individual in his or her trade or profession, and the last two deal with reliefs claimed by an individual as a landlord. The legislation provides a separate formula for apportioning each of the four categories of reliefs.

It is worth noting, that once the apportionment process has been completed, carried-forward non-specified reliefs are deducted from 2007 income before carried-forward specified reliefs.

We deal with each of the four categories below and give an example in each case.

Category 1 – Capital allowances carried forward under s304

This applies to capital allowances made in taxing the individual’s trade or profession that, due to there being insufficient income to utilise the allowances, are carried forward to 2007 under s304(4) TCA 1997.

The amount of the carried-forward relief that is treated as “specified reliefs” in 2007 for the purposes of determining the individual’s 2007 income tax liability in accordance with the calculations in s485C is computed using the following formula:

$$RF \times \frac{SR}{TR}$$

where:

RF = all capital allowances carried forward to 2007, under s304(4)

SR = the aggregate industrial buildings capital allowances made in taxing the individual’s trade or profession for 2003 to 2006 inclusive that are deemed to be specified reliefs (excluding any carried-forward allowances claimed in each of these years),

TR = the aggregate industrial buildings capital allowances (specified and non-specified) and plant and machinery capital allowances made in taxing the individual’s trade or profession for 2003 to 2006 inclusive (again, excluding any carried-forward reliefs claimed in each of these years).

Essentially, the numerator (SR) refers only to industrial buildings capital allowances (Chapter 1 of Part 9) that are specified reliefs (for example, the scheme of accelerated capital allowances for hotels), whereas the denominator (TR) refers to total capital allowances (i.e., all of Part 9).

Example 1

Anne operates a hotel. She has carried-forward capital allowances at 1 January 2007 of €100,000 in relation to her trade (under s304 TCA 1997). The current-year trading profits of the hotel are €1,300,000, and accelerated industrial buildings capital allowances and plant and machinery capital allowances for 2007 are €400,000 and €700,000 respectively.

The allowances claimed in prior years are as follows:

	2003	2004	2005	2006	Total
	€	€	€	€	€
Accelerated industrial buildings capital allowances (i.e., specified)	200,000	200,000	400,000	400,000	1,200,000
Plant and machinery capital allowances (i.e., non-specified)	600,000	600,000	600,000	800,000	2,600,000

The portion of the carried-forward capital allowances of €100,000 (RF) that is allocated to specified reliefs in 2007 is calculated as follows:

Step 1: Look back to the tax years 2003 to 2006 inclusive to determine reliefs claimed

Total specified capital allowances: €1,200,000

Total capital allowances: €3,800,000

Step 2: Apply the formula

RF	€100,000	
SR	€1,200,000	
TR	€3,800,000	
RF allocated to specified reliefs	€31,579	$\frac{€1.2m}{€3.8m}$
RF allocated to non-specified reliefs	€68,421	Balance

In computing the 2007 charge to tax, €31,579 of the capital allowances brought forward are

specified reliefs, and this sum will be added to the current-year specified reliefs of €400,000.

Step 3: Compute 2007 taxable income

(A) Determine if Anne’s adjusted income exceeds the threshold amount and apply restriction if necessary

Anne’s “adjusted income” for 2007 is determined by the formula:

$$(T + S) - R$$

where:

T = Anne’s taxable income before any restrictions,

S = the aggregate of specified reliefs used in the tax year (assuming no restrictions),

R = the amount of ring-fenced income for the tax year, if any.

T is computed as follows:

Trading income	€1,300,000
Less reliefs C/F	€(100,000)
Less current year IBA	€(400,000)
Less current year P&M	€(700,000)
T =	€100,000

S is computed as follows:

Specified relief C/F	€31,579
Current year IBA	€400,000
S =	€431,579
R =	Nil
Adjusted income is therefore	€531,579

(B) Determine if Anne is affected by limitation on relief in 2007

Anne is affected by the limitation on relief in 2007 as:

- (i) her adjusted income of €531,579 is greater than the threshold amount of €250,000,
- (ii) the aggregate of the specified relief of €431,579 is greater than the threshold amount of €250,000 and
- (iii) the aggregate of the specified relief of €431,579 is greater than 50% of the adjusted income of €265,789.

(C) Recalculate 2007 taxable income

As the limitation on relief applies, Anne's income for 2007 is recalculated using the formula:

$$T + (S - Y)$$

where:

T = the taxable income for the year calculated on the basis that the limitation on relief does not apply,

S = the aggregate of specified reliefs used in the tax year (assuming no restrictions),

Y = the greater of:

- (i) the threshold amount and
- (ii) 50% of the adjusted income for the year.

T: Taxable income if no restriction	€100,000
S: Aggregate of specified reliefs used (€400,000 + €31,578)	€431,579
Y: Greater of (i) €250,000 and (ii) €265,789	€265,789
T + (S - Y) New taxable income for 2007	€265,790

Step 4: Calculate specified reliefs carried forward to 2008

The specified reliefs brought forward to 2008 are computed as follows:

Total specified reliefs (€31,5798 C/F + €400,000 2007)	€431,579
Less specified reliefs used	€(265,789)
Specified reliefs brought forward to 2008	€165,790

Category 2 – Losses carried forward under s382

This applies to losses arising in a trade or profession carried on by an individual that are carried forward to 2007 under s382. The type of specified reliefs that this category seeks to identify is the proportion of losses forward that are referable to double rent relief and/or excess industrial buildings capital allowances (that are specified reliefs) used to create or increase a loss.

The amount of the loss carried forward that is allocated to specified reliefs in 2007 is calculated as follows:

$$RF \times \frac{SR}{TR}$$

where:

RF = the trading loss carried forward to 2007,

SR = (DR + SA)

DR is the aggregate of the deductions that the individual was entitled to claim under ss324, 333, 345, 354 and paragraph 13 of Schedule 32 (i.e., double rent relief) for the tax years 2003 to 2006 inclusive. However, the amount for each year is subject to a cap that is calculated using the formula (L - CA), where L is the loss arising in the individual's trade or profession in the year in question and CA is the claim made by the individual in that year to create or augment the trading loss with excess capital allowances (i.e., industrial buildings and plant and machinery).

SA is the aggregate of the industrial buildings capital allowances made in taxing the individual's trade or profession in 2003 to 2006 inclusive that are specified reliefs to the extent

that the individual made a claim to create or augment a trading loss using those allowances.

$$TR = (TL + TA)$$

TL is the aggregate of the losses eligible for relief under s381 for the tax years 2003 to 2006 inclusive.

TA is the aggregate of the capital allowances made in taxing the individual's trade or profession in 2003 to 2006 inclusive, to the extent that the individual made a claim to create or augment a trading loss using those allowances (i.e., same as CA above).

In summary, the numerator (SR) refers only to double rent relief (to the extent that the use of this relief causes a loss to arise) and industrial buildings capital allowances that are specified reliefs used to create or increase a trading loss in the tax years 2003 to 2006 inclusive, and the denominator (TR) refers to the total losses eligible for relief under s381 plus total capital allowances used to create or augment a trading loss in those years.

Example 2

John carries on a trade from two premises; one qualifies for double rent relief, and the other qualifies for accelerated industrial buildings capital allowances. He also claims plant and machinery capital allowances in relation to equipment used in his trade. He has a carried-forward trading loss at 1 January 2007 of €700,000 in relation to his trade (under s382 TCA 1997), and his current-year trading profit is €200,000. No double rent relief is available in 2007.

The allowances and reliefs claimed in prior years are as follows:

	2003	2004	2005	2006	Total
	€	€	€	€	€
Profit/loss	500,000	600,000	300,000	(100,000)	1,300,000
Double rent relief	(600,000)	(600,000)	(600,000)	(600,000)	(2,400,000)
Loss arising in the trade after double rent	(100,000)	Nil	(300,000)	(700,000)	(1,100,000)
Accelerated industrial buildings capital allowances used to augment the trading loss (SA)	(100,000)	(100,000)	Nil	Nil	(200,000)
Plant and machinery capital allowances used to augment the trading loss	(200,000)	(200,000)	Nil	Nil	(400,000)
Total losses (including any capital allowances used to increase losses)	(400,000)	(300,000)	(300,000)	(700,000)	(1,700,000)

The portion of the carried-forward trading loss of €700,000 (RF) that is allocated to specified reliefs in 2007 is calculated as follows:

Step 1: Look back to the tax years 2003 to 2006 inclusive to determine reliefs claimed

	2003	2004	2005	2006	Total
	€	€	€	€	€
Double rent relief (1)	600,000	600,000	600,000	600,000	2,400,000
L (total losses, includes amount of any capital allowances used to increase losses)	400,000	300,000	300,000	700,000	1,700,000
CA (amount of capital allowances used to increase losses)	300,000	300,000	Nil	Nil	600,000
L – CA (2)	100,000	Nil	300,000	700,000	1,100,000
DR, the lesser of (1) the double rent relief and (2) L – CA	100,000	Nil	300,000	600,000	1,000,000
SA (specified reliefs included in amount of capital allowances used to increase losses)	100,000	100,000	Nil	Nil	200,000
SR = DR + SA	200,000	100,000	300,000	600,000	1,200,000
TL (total losses less amount of capital allowances used to increase losses)	100,000	Nil	300,000	700,000	1,100,000
TA (capital allowances used to augment the trading loss)	300,000	300,000	Nil	Nil	600,000
TR = TL + TA	400,000	300,000	300,000	700,000	1,700,000

Step 2: Apply the formula

RF	€700,000	
SR (DR + SA)	€1,200,000 (€1m + €200,000)	
TR (TL + TA)	€1,700,000 (€1.1m + €600,000)	
RF allocated to specified reliefs	€494,118	$\frac{€700,000 \times €1.2m}{€1.7m}$
RF allocated to non-specified reliefs	€205,882	Balance

Step 3: Compute 2007 taxable income

It is assumed that all trading losses and excess capital allowances arising in the tax years 2002 to 2005 inclusive, have been utilised against other income arising in those tax years.

(A) Determine if John's adjusted income exceeds the threshold amount and apply restriction if necessary

John's adjusted income for 2007 is determined by the formula:

$$(T + S) - R$$

where:

T = John's taxable income before any restrictions,

S = the aggregate of specified reliefs used in the tax year (assuming no restrictions),

R = the amount of ring-fenced income for the tax year, if any.

T is computed as follows:

Trading income	€200,000
Less losses C/F	€(700,000)
T =	Nil

S is computed as follows:

Specified relief C/F and used	€200,000
S =	€200,000

R =	Nil
-----	-----

Adjusted income is therefore	€200,000
------------------------------	----------

(B) Determine if John is affected by limitation on relief in 2007

John is not affected by the limitation on relief in 2007 as the three tests below have not been satisfied:

- his adjusted income of €200,000 is not greater than or equal to the threshold amount of €250,000,
- the aggregate of the specified relief of €200,000 is not greater than or equal to the threshold amount of €250,000 and
- the aggregate of the specified relief of €200,000 is not greater than 50% of the adjusted income of €100,000.

(C) Recalculate 2007 taxable income

Not applicable.

Step 4: Calculate specified reliefs carried forward to 2008

The specified reliefs brought forward to 2008 are computed as follows:

Total specified reliefs (€494,118 C/F + €Nil 2007)	€494,118
Less specified reliefs used	Nil
Specified reliefs brought forward to 2008	€494,118

In addition, non-specified reliefs of €5,882 would also be carried forward to 2008.

Category 3 – Case V capital allowances carried forward under s305

This applies to industrial buildings capital allowances that were claimed in taxing an individual's rental income and that are carried forward to 2007.

The amount of the capital allowances that are allocated to specified reliefs in 2007 is calculated as follows:

$$RF \times \frac{SR}{TR}$$

where:

RF = the Case V capital allowances carried forward to 2007,

SR = the aggregate of the industrial buildings capital allowances made to the individual (i.e., allowances granted under Chapter 1 of Part 9) in respect of Irish rental property for the tax years 2003 to 2006 inclusive, that are regarded as specified reliefs (e.g., the scheme of accelerated capital allowances for hotels, hospitals, nursing homes and for commercial buildings located in Urban Renewal Areas, Town Renewal Areas, etc.),

TR = the aggregate of total industrial buildings capital allowances made to the individual in respect of Irish rental property for the tax years 2003 to 2006 inclusive.

Example 3

Angela owns a number of nursing homes and a factory building. She has carried-forward capital allowances at 1 January 2007 of €600,000 in relation to these rental properties (under s305 TCA 1997). Rent for 2007 is €1,300,000. Current-year industrial buildings allowances in relation to the nursing homes amount to €1m, and current-year industrial buildings capital allowances in relation to the factory are €300,000.

Reliefs claimed in prior years are as follows:

	2003	2004	2005	2006	Total
	€	€	€	€	€
Specified industrial buildings capital allowances (nursing homes)	600,000	600,000	1,000,000	1,000,000	3,200,000
Non-specified industrial buildings capital allowances (factory)	300,000	300,000	300,000	300,000	1,200,000

The portion of the carried-forward Case V capital allowances of €600,000 (RF) that is allocated to specified reliefs in 2007 is calculated as follows:

Step 1: Look back to the tax years 2003 to 2006 inclusive to determine reliefs claimed

Total specified industrial buildings capital allowance: €3.2m.

Total industrial buildings capital allowances: €4.4m.

Step 2: Apply the formula

RF	€600,000	
SR	€3,200,000	
TR	€4,400,000	
RF allocated to specified reliefs	€436,364	€600,000 x €3.2m €4.4m
RF allocated to non-specified reliefs	€163,636	Balance

Step 3: Compute 2007 taxable income

(A) Determine if Angela's adjusted income exceeds the threshold amount and apply restriction if necessary

Angela's adjusted income for 2007 is determined by the formula:

$$(T + S) - R$$

where:

T = Angela's taxable income before any restrictions,

S = the aggregate of specified reliefs used in the tax year (assuming no restrictions),

R = the amount of ring-fenced income for the tax year, if any.

T is computed as follows:

Case V rental income	€1,300,000
Less losses C/F, s305	€(600,000)
Less 2007 non-specified reliefs	€(300,000)
Less 2007 specified reliefs	€(1,000,000)
T =	Nil

S is computed as follows:

Specified relief C/F and used	€436,364
Current-year specified reliefs used*	€400,000
S =	€836,364

* This is computed as follows:

Case V rental income	€1,300,000
Less 2006 specified reliefs C/F	€(436,364)
Less non-specified reliefs C/F	€(163,636)
Less 2007 non-specified reliefs	€(300,000)
Balance	€400,000

R =	Nil
Adjusted income is therefore	€836,364

(B) Determine if Angela is affected by limitation on relief in 2007

Angela is affected by the limitation on relief in 2007 as:

- (i) her adjusted income of €836,364 is greater than the threshold amount of €250,000,

- (ii) the aggregate of the specified relief of €836,364 is greater than the threshold amount of €250,000 and
- (iii) the aggregate of the specified relief of €836,364 is greater than 50% of the adjusted income of €418,182.

(C) Recalculate 2007 taxable income

As the limitation on relief applies, Angela's income for 2007 is recalculated using the formula

$$T + (S - Y)$$

where:

T = the taxable income for the year calculated on the basis that the limitation on relief does not apply,

S = the aggregate of specified reliefs used in the tax year (assuming no restrictions) and

Y = the greater of:

- (i) the threshold amount and
- (ii) 50% of the adjusted income for the year.

T: Taxable income if no restriction	Nil
S: Aggregate of specified reliefs used	€836,364
Y: Greater of (i) €250,000 and (ii) €418,182	€418,182
T+S - Y New taxable income	€418,182

Step 4: Calculate specified reliefs carried forward to 2008

The specified reliefs brought forward to 2008 are computed as follows:

Total specified reliefs (€436,364 C/F + €1m 2007)	€1,436,364
Less specified reliefs used	€(418,182)
Specified reliefs brought forward to 2008	€1,018,182

Category 4 – Case V losses carried forward under s384

This applies to a loss arising in relation to Irish rental property carried forward to 2007.

The amount of the carried-forward loss that is allocated to specified reliefs in 2007 is calculated as follows:

$$RF \quad \times \quad \frac{SR}{TR}$$

where:

RF = the Case V loss carried forward to 2007, under s384,

SR = the aggregate of the deductions that the individual was entitled to claim under ss372AP and 372AU TCA 1997 (i.e., “Section 23” relief and “Section 50” student accommodation relief) in the tax years 2003 to 2006 inclusive,

TR = the aggregate of the deductions that the individual was entitled to under s97(2) in calculating his/her taxable Case V income in the tax years 2003 to 2006 inclusive, including the reliefs referred to in the definition of SR.

Example 4

Mike purchased “Section 23” properties in the tax years 2003 to 2006 inclusive. Mike has a carried-forward Case V loss at 1 January 2007 of €350,000 (under s384 TCA 1997). Case V rental income in 2007 is €650,000, and deductions under s97(2) amount to €90,000.

The portion of the carried-forward Case V loss of €350,000 (RF) that is allocated to specified reliefs in 2007 is calculated as follows:

Step 1: Look back to the tax years 2003 to 2006 inclusive

	2003	2004	2005	2006	Total
	€	€	€	€	€
Section 23 relief	600,000	300,000	800,000	600,000	2,300,000
Other Case V deductions, e.g. mortgage interest	55,000	70,000	75,000	75,000	275,000

Step 2: Apply the formula

RF	€350,000	
SR	€2,300,000	
TR	€2,575,000	
RF allocated to specified reliefs	€312,621	€350,000 x $\frac{€2.3m}{€2.575m}$
RF allocated to non-specified reliefs	€37,379	Balance

Step 3: Compute 2007 taxable income

(A) Determine if Mike’s adjusted income exceeds the threshold amount and apply restriction if necessary

Mike’s adjusted income for 2007 is determined by the formula:

$$(T + S) - R$$

where:

T = Mike’s taxable income before any restrictions,

S = the aggregate of specified reliefs used in the tax year (assuming no restrictions),

R = the amount of ring-fenced income for the tax year, if any.

T is computed as follows:

Case V income	€650,000
Less Case V loss C/F	€(350,000)
Less current-year deductions	€(90,000)
T =	€210,000

S is computed as follows:

Specified relief C/F and used	€312,621
Current-year specified reliefs used	Nil
S =	€312,621
R =	Nil
Adjusted income is therefore	€522,621

(B) Determine if Mike is affected by limitation on relief in 2007

Mike is affected by the limitation on relief in 2007 as:

- (i) his adjusted income of €522,621 is greater than the threshold amount of €250,000,
- (ii) the aggregate of the specified relief of €312,621 is greater than the threshold amount of €250,000 and
- (iii) the aggregate of the specified relief of €312,621 is greater than 50% of the adjusted income of €261,310.

(C) Recalculate 2007 taxable income

As the limitation on relief applies, Mike's income for 2007 is recalculated using the formula:

$$T + (S - Y)$$

where:

T = the taxable income for the year calculated on the basis that the limitation on relief does not apply,

S = the aggregate of specified reliefs used in the tax year (assuming no restrictions) and

Y = the greater of:

- (i) the threshold amount and
- (ii) 50% of the adjusted income for the year.

T: Taxable income if no restriction	€210,000
S: Aggregate of specified reliefs used	€312,621
Y: Greater of (i) €250,000 and (ii) €261,310	€261,310
T + S - Y: New taxable income	€261,310

Step 4: Calculate specified reliefs carried forward to 2008

The specified reliefs brought forward to 2008 are computed as follows:

Total specified reliefs (€312,621 C/F + €Nil 2007)	€312,621
Less specified reliefs used	€(261,310)
Specified reliefs brought forward to 2008	€51,311

Conclusion

The purpose of this legislation is to provide a mechanism for apportioning certain carried-

forward tax reliefs at 1 January 2007 between specified reliefs and non-specified reliefs for the purposes of calculating a taxpayer's 2007 income tax liability. However, as you can see from the above, the legislation is quite complex in places, particularly with respect to Category 2 (losses carried forward under s382). The legislation, however, gives the taxpayer the right to seek an alternative basis of apportionment, based on a longer or shorter look-back period, if he or she is not satisfied with the result generated by the formulae in Schedule 25C. After the rush to the 2006 filing deadline comes to an end, it is worth putting aside some time to carry out these calculations as the results could have a significant impact on 2007 and subsequent income tax liabilities.

The authors would like to express their appreciation to Mr Eugene Creighton, Principal Officer, Strategic Planning Division, Revenue Commissioners, for his assistance in relation to this article.

Position: Tax Consultant**Principal Duties & Responsibilities****Reporting to the Tax Director, the role will involve:**

- » Identifying tax planning opportunities for both existing and new clients
- » Manage existing client relationships and developing new ones
- » Servicing the tax requirements of a wide diverse client base on all aspects of taxation including corporate, capital gains, capital acquisitions, income and indirect taxes
- » Advising on both corporate and personal tax planning

Educational/Professional Qualification:

- » AITI Qualification

Experience Skills and Personal Qualities:

- » Excellent organisational and planning capabilities
- » Excellent communication and interpersonal skills
- » Proactive with ability to prioritise and meet deadlines
- » Strong focus on client development



Please reply in confidence to:

**John Hourigan, Director of Tax,
Mulcahy Gorman Mulcahy
70/71 O'Connell Street, Limerick**

T: (061) 413777

E: johnhourigan@mulcahygormanmulcahy.com