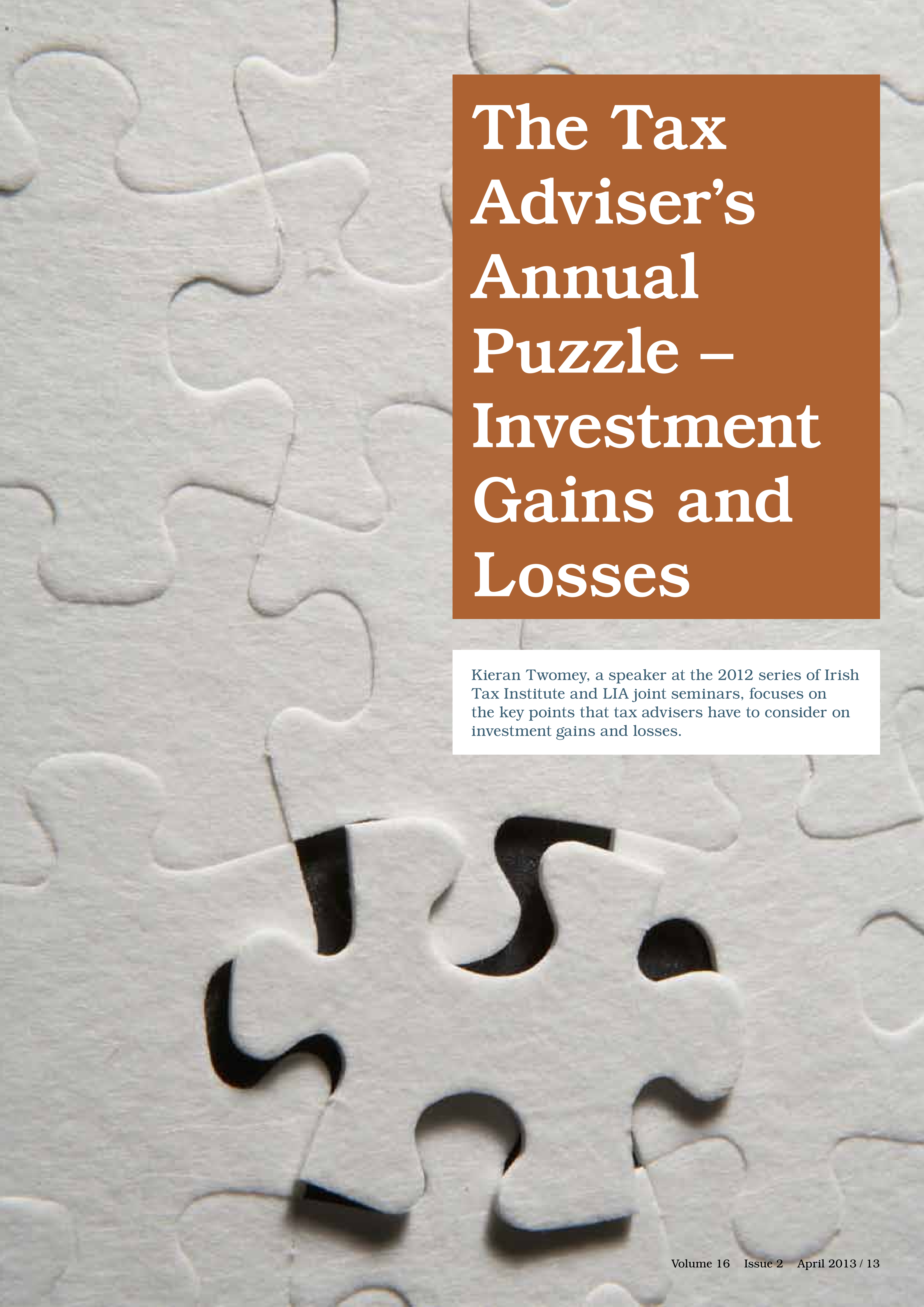

The Tax Adviser's Annual Puzzle – Investment Gains and Losses

Kieran Twomey, a speaker at the 2012 series of Irish Tax Institute and LIA joint seminars, focuses on the key points that tax advisers have to consider on investment gains and losses.

Kieran Twomey
Twomey Moran
Taxation Advisers

Each year, tax advisers are presented with the "puzzle" of analysing clients' investments to determine the extent to which a tax charge arises, the rate of tax, and unfortunately in a lot of cases, the extent to which investment losses can be used to reduce tax charges.

This exercise has become a puzzle for two reasons. Firstly, the tax rules have become quite complicated over the years and, secondly, clients have become more sophisticated investors. This article focuses on the key points that tax advisers have to consider on investment gains and losses.

The rate of tax

The rates of tax that apply to individuals today have never been more complex. The key rates of tax that apply on investment gains are:

Capital gains tax	33%
Gains on Irish/EU investment funds[1]	36%
Annual payments from Irish/EU investment funds	33%
Income/gains on non EU investment funds	55% (max rate)

Since 2007, we have seen a significant increase in the rate of tax on investment gains. For example:

	2007 rate	2013 rate	% increase
Capital gains tax	20%	33%	+65%
Irish/EU fund gains	23%	36%	+57%

Tax analysis

The approach we take in assessing investment gains and losses is to:

– Firstly, understand the nature of the investment. Is the investment an asset within the capital gains tax rules or is it an asset within the investment fund rules? This can be a complex exercise in many cases.
– Secondly, if the asset is within the capital gains tax rules, is the asset a "chargeable asset" for capital gains tax and therefore eligible for capital gains tax loss relief?
– Thirdly, if the asset is within the investment fund rules, is there any measure of loss relief available?

Investment losses

Unfortunately, we spend a lot of time analysing investment losses. The "ground rules" that we apply in assessing investment losses are as follows:

1. Not all assets are chargeable assets for capital gains tax. If the asset is not a chargeable asset, then there is no capital gains tax loss relief available on the asset. It is surprising the number of investments that were made during the "boom" years that potentially fall into the category of non chargeable assets (with the result that no loss relief is available).
2. If the asset is a chargeable asset for capital gains tax then the loss on that asset is available for offset against chargeable gains of that year of assessment and is then carried forward to the following year of assessment and so on.

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3. If the loss arises on an offshore fund located in an EU country, an EEA country or an OECD country with which Ireland has concluded a double taxation agreement (an "EU investment fund"), no loss relief of any description is available in relation to that investment loss. Typical examples of EU investment funds in this category tend to be ETF's generally, iShares, Powershares etc.
4. If the investment loss arises on a fund located in a "bad offshore fund" i.e. a fund located outside of the EU, EEA and an OECD country with which Ireland has concluded a double taxation agreement, capital gains tax loss relief is available if the asset is a chargeable asset. While the "bad offshore fund" rules do not specifically deal with the availability of losses, CGT loss relief should be available.

Some of the rules on losses are harsh. For instance, the inability to be able to set an investment loss that arises on an EU investment fund against a gain that arises on another EU investment fund in the same year. Unfortunately the legislation is clear in this regard.

I have encountered numerous examples of this over the last two years. One such example of the harshness of this rule arose recently for a client who had transactions as follows:

	EUR
Gain on Luxembourg (SICAV) fund	400,000
Loss on UK fund (OEIC)	(300,000)
Net client gain to client	100,000
Taxable	400,000
Tax payable (2012 rate) at 33%	132,000
Tax as a % of client net gain	**132%**

The only tax solution to this scenario is to continue to hold the loss making fund until the fund recovers to its original investment level. This of course might not be the investment advice.

The 36% rate of tax on EU investment funds is only available where details of the disposal are correctly included on the tax return. This is a point that I have seen questioned by the Revenue so it is important to ensure the tax return is completed correctly. There is a section on the tax return to include details of EU investment fund disposals.

More capital gains?

Gains on EU investment funds have a tax rate of 36% in 2013. However, for a client with capital gains tax lossest carried forward, a gain on the EU investment fund is taxable at 36% (because it is an income gain) with no relief for any capital gains tax losses.

The tax efficient investment for a client with capital gains tax losses carried forward is to receive investment returns in the form of capital gains.

8 year charge on funds

One issue that we will start to see more of going forward is the eight year deemed charge that applies to Irish investment funds and EU investment funds introduced back in 2006. The eight year charge is a deemed disposal and reacquisition of a fund investment where the fund investment has been held for more than eight years. The eight year charge only applies to funds acquired on or after 1 January 2001 so the charge applied for the first time in 2009. Where this arises, it may come as a nasty surprise and cashflow cost to clients.

Foreign currency gains

Some of the money transferred out of Ireland has been converted out of Euro amid concerns about the stability of the Euro. This creates a potential foreign currency capital gain or capital loss if foreign currency is transferred either to another foreign currency or converted back to Euro. Let me illustrate this by way of a recent client example.

Example – Euro transfer to US Dollars (USD)

1 February 2012	Client transfers EUR1m from Irish bank to US bank in USA and converts EUR to US Dollars
1 February 2012	Client holds US Dollars of 1,317,500 in US bank (Euro/USD fx rate on 1 February was 1.3175)
2 July 2012	Client converts all US Dollars to Euro and receives EUR1,046,216 (fx rate on 2 July 2012 was 1.2593)

The client has a capital gains tax position as follows:

		EUR
2 July 2012	Proceeds	1,046,216
1 February 2012	Less cost	(1,000,000)
	Capital gain	**46,216**

The future of losses?

Under the NAMA Act, losses of all NAMA participating institutions are restricted in how the losses can be used. There are other precedents for loss restrictions but the NAMA institution restriction highlights the risk that may lie ahead for individual (and corporate) losses carried forward.

In recent months, there was industry speculation that a Budget or Finance Bill might restrict capital gains tax losses on certain assets in some way. In the recently published Department of Finance Tax Strategy Papers for the Budget in December 2011, the following was one of the many matters considered by the Tax Strategy Group (Ref. 11/06) on 13 September 2011:

"Amendment of loss relief

At present if a taxpayer makes a loss on the disposal of an asset that loss can be set against gains made in the current year and carried forward indefinitely against gains in subsequent years. The significant decline in value of capital assets in recent years has the potential to affect the CGT yield for several years to come. [It appears many people are either holding onto assets or are unable to dispose of them in the current market.] To protect the CGT yield, consideration could be given to restricting loss relief to a maximum amount per year (for example, €50,000) or to a maximum of 50% of all chargeable gains made in a year".

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