Cost of acquisition / enhancement where debt released - restriction of allowable cost for CGT purposes (S.552)

Part 19-02-10A

This document should be read in conjunction with section 552 of the Taxes Consolidation Act 1997

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Revenue
Cáin agus Custaim na hÉireann
Irish Tax and Customs

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Introduction

Section 552 of the Taxes Consolidation Act 1997 ("TCA 1997") provides for the basic rules for determining the expenditure to be allowed in computing chargeable gains. Allowable expenditure includes cost of acquisition of an asset, enhancement expenditure incurred during the period of ownership of the asset and costs incurred in disposing of the asset. It provides, in relation to the cost of assets acquired with borrowings where the borrower is released from payment of all or part of the debt, that the cost of acquisition is to be restricted by the amount of any debt released where a loss arises on the disposal of the asset.

10A.1 Restrictions on the amount of losses allowable

Section 42 of Finance (No 2) Act 2013, introduced a new **subsection 552(1B), TCA 1997**, which applies restrictions on the amount of losses allowable on the disposal of an asset, by taking into account the release from payment of debts in respect of money borrowed to acquire or enhance an asset. The restrictions apply to disposals made on or after 1 January 2014 whether the debt was released before, on or after that date.

The application of the restriction cannot apply so as to turn a loss (calculated as if the subsection did not apply) into a chargeable gain (when the subsection is applied).

10A.2 Restriction of allowable cost of acquisition / enhancement

Section 552(1B) TCA 1997 ensures that only the real economic capital cost of the asset to its owner is allowed as a deduction for Capital Gains Tax ("CGT") purposes by restricting the allowable cost of acquisition and enhancement expenditure where debt is released before, on or after the disposal of the asset.

Accordingly, where an asset is acquired with borrowings, from which the borrower has been in whole or in part released from repaying, that part of the cost of acquisition or enhancement expenditure not actually borne – because all or part of the debt is released – and as such is not allowable in computing an allowable loss. The restriction applies to disposals of assets made on or after 1 January 2014 where the debt has been released before, on or after the disposal.

The effect of this restriction is to ensure that a person cannot claim the benefit of a CGT loss where no economic loss has been incurred.

Example 1

Debt Released before, on or after the disposal:

An individual borrows (say) €800,000 from a bank and buys a property for €1 million. Because of the downturn in the economy, the individual cannot meet the repayments on the loan and the value of the property has fallen to (say) €500,000. The individual enters into an agreement with the bank in year 1 under which the individual agrees to sell the property as soon as possible and pay the proceeds to the bank. The bank in turn agrees to forgo the remainder of the debt of €300,000. The property is sold in year 2 for €500,000.

But for **section 552(1B)(b) TCA 1997**, the loss for CGT purposes on the disposal of the property would be:

Sale price	€500,000
Cost price	€1,000,000
Loss for CGT	(€500,000)

However, **section 552(1B)(b) TCA 1997** applies to reduce the cost price by the amount of the borrowing forgone by the bank (as the taxpayer is released from that amount of the debt).

So, the computation of the allowable loss will instead be:

Sale price		€500,000
Cost price	€1,000,000	
Restriction by the amount of debt released	€300,000	€700,000
Loss for CGT		(€200,000)

Example 2

Limitation of reduction of base cost to lower of debt released or loss calculated if the subsection did not apply.

In year 1 an individual borrows €1 million to purchase an asset for €1million.

He or she cannot meet his or her repayments and in year 5 accumulated interest of €400,000 is added to the amount of the loan (i.e. loan now €1.4 million). The value of the asset falls to €500,000, and the asset is sold to meet part of the debt and the bank releases the remainder of the debt of €900,000.

Computation:

In year 5 the individual would have a loss of €500,000 for CGT purposes (i.e. sale price €500,000 – cost €1 million) **if section 552(1B)(b) TCA 1997 did not apply.**

Applying the restriction under **section 552(1B)(b) TCA 1997**, the computation is as follows:

Sale Price		€500,000
Less Cost		€1,000,000
		€500,000
Restricted to the lower of:		
a) Loss (as calculated above), or	€500,000	
b) Debt released	€900,000	(€500,000)
Net loss for CGT		NIL

10A.3 Debt release after year of disposal of asset

Where a debt is released in a year of assessment after the year in which the asset is disposed of – such that the base cost of the asset will not have been reduced by the amount of the debt at the time of computing the loss on the disposal – then a chargeable gain equal to the amount of the debt released is deemed to accrue in the year of assessment in which the debt is released.

Example 3

Application of section 552(1B)(d) TCA 1997

The facts are the same as in example 1 except that the bank does not release the individual from the remainder of the debt of €300,000 until the year after the year of disposal of the asset.

The loss for CGT purposes on the disposal of the property is:

Sale price	€500,000
Cost price	€1,000,000
Loss for CGT in Year 1	(€500,000)

(No restriction applies at this point as the debt is not released).

When the debt is released in the following year there is a deemed chargeable gain of €300,000 – i.e. equal to the amount of the debt released.

The net position over the two years is:

Year 1 CGT Loss	(€500,000)
Year 2 CGT Deemed Gain	€300,000
Net Loss over the two years	(€200,000)

10A.4 Disposal to a connected person

Ordinarily, where there is a disposal of an asset to a connected person, the use to which any allowable loss may be put is restricted to it being used against a gain on the disposal of some other asset to the same connected person, in accordance with **section 549(3) TCA 1997**. However, in relation to a loss (as in year 1, in example 3) incurred on a disposal to a connected person, followed by a deemed chargeable gain (as in year 2, in example 3), the deemed chargeable gain is to be treated as if it accrued on a disposal to the connected person - so that the loss can be set off against the deemed chargeable gain.

But for this provision an individual could have an unrelieved capital loss that would not be available to offset against a subsequent deemed chargeable gain.

10A.5 Disposal of an asset by a receiver

Where a receiver, manager or factor appointed to enforce a security, charge or encumbrance on the asset disposes of the asset, that disposal is treated (in accordance with **section 537(2), TCA 1997**) as being made as nominee for the owner of the asset subject to the security, charge or encumbrance, i.e. the debtor. Any loss arising on the disposal is a loss of the owner (the debtor) of the asset subject to the security, charge or encumbrance.

The subsequent release of a debt, in respect of borrowed money used to acquire or enhance an asset, in a year of assessment after the year in which the asset is disposed of at a loss by a receiver, manager or factor (as appropriate) acting on the instructions of a creditor, gives rise to a deemed chargeable gain under **section 552(1B)(d) TCA 1997**. This deemed chargeable gain is the gain of the owner of the asset (the debtor) and not of the creditor, receiver, manager or factor, (as appropriate) who disposed of the asset in a preceding year, as the nominee on behalf of the person entitled to the asset, subject to the security, charge or encumbrance.

Example 4

An individual borrowed €1 million from a bank and acquired a property at a cost price of €1 million. The individual cannot meet the repayments to the bank, which appoints a receiver to dispose of the property. Property is sold for €500,000 and the following year the bank forgoes the remainder of the outstanding loan of €300,000.

Loss in year of disposal of property

The loss for CGT purposes on the disposal of the property is:

Sale price	€500,000
Cost price	€1,000,000
Loss for CGT in Year 1	(€500,000)

(No restriction applies at this point as the debt is not released).

Although the property was sold by the receiver, the allowable loss is that of the owner (debtor).

Deemed chargeable gain

When the remainder of the debt is released by the bank in the following year there is a deemed chargeable gain of €300,000 – i.e. equal to the amount of the debt released.

This deemed chargeable gain is also a gain of the owner of the property (debtor).

The net position, as regards the owner of the property i.e. the debtor, over the two years is:

Year 1 CGT Loss	(€500,000)
Year 2 CGT Deemed Gain	€300,000
Net Loss over the two years	(€200,000)

10A.6 Deemed chargeable gain on non-chargeable assets

Section 552(1B)(e) TCA 1997 puts beyond doubt that the release of a debt in relation to an asset that is not a chargeable asset, or one that is relieved from CGT, cannot give rise to a deemed chargeable gain under **subsection (1B)(d) of section 552 TCA 1997**.

10A.7 Release of debt by a member of a group

Section 552(1B)(f) TCA 1997, provides that the loss restriction under **section 552(1B)(b) TCA 1997** or the deemed chargeable gain under **section 552(1B)(d) TCA 1997** do not apply to the release by one member of a group of companies of a debt in respect of money borrowed by another member of the group as such borrowings are neutral as regards the group as a whole.

10A.8 Date on which debt is released

Section 552(1B)(c) TCA 1997 specifies that the date on which a debt is released is to be determined on the same basis as the release of a specified debt is treated as having been effected in **section 87B(4), TCA 1997**.