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No refusal of relief under tax deferral scheme rules for unplanned loss

The Supreme Tax Court has held that a loss incurred on an investment project of a closed-circle investment fund can be deducted by investors from their other income if the loss was not pre-planned and factored into the fund's yield calculations.

The Income Tax Act provides that losses incurred by fund investors in tax deferral schemes may only be carried forward for offset against future income from the same source. This provision was introduced to counter an increasingly wide-spread practice by fund managers and promoters of attracting investment from the general public in projects of dubious viability with the offer of initial loss allocations for immediate offset against other income. The tax benefit from investing in these so-called “tax deferral schemes” was often highlighted in their advertising literature and “sold” as outweighing the business imponderables of the project. The management company of an investment fund in equipment leasing objected to the tax office’ description of the fund as a tax deferral scheme with consequent denial of immediate offset rights for the investors on the grounds that tax benefits at no time played a part in the fund’s business planning. Also neither they, nor any other tax topics, were mentioned in the advertising literature, though the tax office’ reply to this point was that they were not mentioned merely so that they should not be immediately obvious.

The Supreme Tax Court has now confirmed the lower court’s decision that the fund in question was not a tax deferral scheme. Its investors were therefore entitled to offset their initial loss allocations (resulting mainly from advance depreciation under an investment incentive provision) against their other income. The court made the point that a tax deferral scheme took tax benefits for the investors into account in its initial planning. That these might not be apparent to the investors at the time was unimportant; what mattered was that they should be available to the investors in the annual profit and loss allocations. In the case at issue, the fund had not reckoned with an initial loss and the loss actually shown had resulted from a last minute decision to claim advance depreciation in its tax return. Thus the loss had not been taken into account at the planning stage.

Supreme Tax Court judgment IV R 59/10 of February 6, 2014 published on March 26

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