

TAXREP 57/05

LOSSES: PARTNERSHIPS AND FILM-RELATED PROVISIONS

TAX LAW REWRITE: BILL 4

Memorandum submitted in November 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in September 2005 by HMRC Tax Law Rewrite Team

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INTRODUCTION

1. We welcome the opportunity to comment on Paper CC(05)29 published on 13 September 2005 by HMRC Tax Law Rewrite Team at <http://www.hmrc.gov.uk/rewrite/exposure/menu.htm>.
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are in the Annex.

GENERAL COMMENTS

3. We note that the clauses in the first Chapter of Paper CC/SC(05)29 will follow the Chapter about trade losses in Bill 4. The rewritten clauses, whilst following the same basic structure, are an improvement on the source legislation in sections 117 and 18ZA-ZO of ICTA. The extensive cross-referencing within the source legislation makes it difficult to understand, which is surprising as it is of relatively recent origin, and the rewritten clauses are easier for the user to follow. The introductory clause 1 (Introduction to Chapter) is a helpful guide to the application of the clauses respectively to a limited partner, to a member of a limited liability partnership, to a non-active partner in an early tax year and to the restrictions on loss reliefs for film trades carried on in partnership, as well as linking-up with the clauses concerning avoidance involving trading losses.
4. We also note that the clauses in the second Chapter of Paper CC/SC(05)29 will be located in a Part of Bill 4 about avoidance. We appreciate that this chapter incorporates separate pieces of source legislation, from FA 2004 and from FA 2005 with the rewritten clauses relating to the latter now positioned before those originating in FA 2004. Nevertheless the extent of the changes in the rewritten presentation of the detail of source legislation of such recent origin is rather surprising, and again brings into question the extent to which tax law rewrite technique is being effectively adopted by Finance Bill draftsmen.
5. Apart from other minor comments we are, however, generally content with the rewrite of the clauses as included in the two Chapters.

ANSWERS TO QUESTIONS

6. **Q1** We agree the proposal to incorporate into the rewritten clauses express references to capital gains tax relief under what will be section 261B of TCGA 1992.
7. **Q2** We agree the proposal to measure the contribution at the end of a basis period rather than the end of a tax year.

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8. **Q3** It is more logical to draft in terms of “contribution to the firm” rather than “contribution to the trade” and we agree that it would then become necessary to provide for only an appropriate part of the contribution to “qualify” if the firm carries on activities other than the trade in point. Restricting relief by reference to the aggregate amount of losses from all trades (where more than one) carried on as a limited partner in a firm would be helpful in this context. We note, however, the implication from Explanatory Notes paragraph 18 that the contribution would also require restriction where the firm used it to fund any investments etc that the firm might hold, and this introduces a complexity. We assume that these types of situation will have been met with already in practice, and further assume that any prospective drafting would take account of such experience.
9. **Q4** For the purpose of determining the individual’s contribution to a trade, it must be correct to ignore withdrawals of capital which have been charged to tax as profits of the trade and we accordingly agree the PRC in clause 4(4) and clause 7(4).
10. **Q5** We agree that the meaning of trading “profits”, for the purposes of clause 4 (Meaning of “contribution to the trade”), is adequately expressed in clauses 4(6) and (7). In particular, that the individual’s entitlement to profits is cumulative and is not reduced by losses.
11. **Q6** Explanatory Notes paragraphs 35 and 36 are helpful to the user in explaining the meaning of the liability on a winding-up. This is particularly so because of the importance of what is specified in the LLP agreement, but also towards understanding clause 7(5) which quantifies Amount B as being only the excess of the amount of the individual’s liability on a winding-up of the LLP over Amount A (whereas the source legislation in s 118ZC(2) of ICTA, to the same effect, effectively identifies the member’s contribution as being the greater of Amount A or Amount B).
12. **Q7** We agree that clause 28 (Meaning of “contribution to the trade”) is correctly rewritten on the basis that undrawn profits are not included in the amount treated as contributed as capital. As this differs from the “contribution to the trade” definition in the rules for limited partnerships (in clauses 4 and 10), we consider that for the avoidance of any doubt it would be clearer to the user if clause 28 were to explicitly state that undrawn profits are not included. However, we hold no strong view on this.

SPECIFIC COMMENTS ON DRAFT LEGISLATION

13. **cl 24 Individuals claiming sideways or capital gains relief for film-related losses (1)(a)** Is it considered unnecessary to rewrite s 119(6) FA 2004, on the basis that it is inherent in s 119(1)(a) FA 2004 that it is immaterial when the loss relief claim is made and as overt references to the 10 December 2003 commencement date of the source legislation are dispensed with in the rewrite?
14. **(6)(c)** What is the authority for stating that it does not matter for the purposes of s 24 if a relevant disposal is part of a larger disposal?

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15. **cl 35 Supplementary provision relating to calculation of maximum amount**
(2) Should the expenditure incurred exclude expenditure incurred before 10 February 2004 in the circumstances predicated in s 128(4) FA 2004?

DETAILED COMMENTS ON DRAFTING

16. **cl 1 Introduction to Chapter**
(4)(b) Should “trading” be inserted before “losses” at the end of the second line?
17. **cl 2 Meaning of “sideways relief” and “capital gains relief”**
(1)(b) Is a signpost needed to make clear what ‘early trade losses relief’ means?
18. **cl 6 Restrictions on reliefs for members of LLPs**
(5)(b) Is a signpost needed to section 11 (non-active partner), as in the case of clause 3(5)(b)?
19. **Schedule Consequential Amendments – Part 2**
In new s 261B(6)(b) of TCGA (Treating trade loss etc as CGT loss) we note the reference to “permanently ceased”. We have no objection to this, although s 72(6) FA 1991 refers only to “ceased” (to carry on the trade etc).

TJH/PCB
11.11.05

WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.