

TAXREP 38/04

RELIEF FOR LOSSES: TAX LAW REWRITE: BILL 4

Memorandum submitted in August 2004 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in June 2004 by the Inland Revenue Tax Law Rewrite Team

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RELIEF FOR LOSSES: TAX LAW REWRITE: BILL 4

A GENERAL COMMENTS

1. We welcome the opportunity to comment on Paper CC(04)10 (Bill 4: Relief for Losses) dated 30 June 2004 and published by the Revenue's Tax Law Rewrite team at <http://www.inlandrevenue.gov.uk/rewrite/exposure/menu.htm>.
2. The Loss relief Part is generally well drafted, and clarifies the operation of the various loss reliefs.
3. It is appropriate to set out the reliefs in separate Chapters and we have no objection to following the order in which the types of income concerned are set out in the draft ITTOIA; distinguishing trade losses, property business losses, losses in an employment or office, and the former 'Case VI' losses from miscellaneous transactions.
4. We note that restrictions on losses in partnerships, losses on unquoted shares in trading companies and post-cessation expenditure will be addressed at a later stage.
5. Chapter 2 (Trade Losses) is generally well-structured, covering the various loss reliefs and anti-avoidance provisions in a presentation and language which the reader should find easier to follow. It might be argued that clause 32 (Ring fence income: trade loss relief against general income and early trade losses relief) fits better after clause 19, and clause 33 (Ring fence trades: carry-forward trade loss relief) after clause 22; but the present separate isolation of clauses 32 and 33 together under the Oil extraction and related activities heading also has merit.
6. In Chapter 3 (Losses from property businesses) we agree that clause 36, dealing with carry-forward relief for losses without restriction, appropriately appears before the general income relief clauses as the latter clauses are restricted to losses partly attributable to capital allowances or allowable agricultural expenses.
7. Chapter 5 deals capably with the utilisation of losses from miscellaneous transactions (the old 'Case VI' loss regime).

B QUESTIONS

8. **Q1** Agreed. The Loss Relief Part deals with how relief for a loss is given, and it is reasonable to assume that the rules for actually calculating trade (and property) losses are dealt with elsewhere in the tax legislation (as they are, through the ITTOIA provision that losses are calculated in the same way and in respect of the same period as profits).
9. **Q2** We agree that it is unnecessary to include in Chapter 2 a specific reference that an amount of a loss of a trade can only be included in the calculation of the loss for

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the first only of two successive years where it would otherwise be included in the loss calculation for both years. Clause 202 of ITTOIA already provides for this, in arriving at the amount of the loss which is deductible, Chapter 2 being concerned only with how relief is given for the deductible loss.

10. **Q3** We agree that it is appropriate (for the purposes of the exception from the clause 15 restrictions on trade loss relief against general income and early trade losses relief) that the periods during which an individual must meet the time commitment test, must carry on the trade and the basis period in respect of which trade leasing allowances arise should be aligned.
11. **Q4** It is appropriate that clause 23 (Business transferred to a company) should reflect Inland Revenue practice of allowing the taxpayer to choose the order in which deductions are made from different sources of income.
12. **Q5** We agree the proposal to make it clear in clause 25 (Carry-forward of certain patent royalties as loss) that s 387 ICTA applies only to patent royalties.
13. **Q6** We agree the proposal to include offices, together with employments, in clause 43 allowing loss relief claims against general income.
14. **Q7** We welcome the proposal not to rewrite s 384A ICTA (Restriction of set-off of allowances against general income) as applicable to employees.
15. **Q8** We welcome the proposal to draft s 261A(1)(a) TCGA 1992 so as to allow a taxpayer, in accordance with current Inland Revenue practice, to make a claim to set-off unutilised income tax losses against capital gains where the taxpayer has no income and accordingly cannot make a claim under s 380 ICTA (to first set-off the losses against income) as currently required by s 72(1) FA 1991.

C SPECIFIC COMMENTS ON DRAFT CLAUSES

cl 1 Overview of Part

16. **sc (1)** As a minor stylistic point, the descriptions of Chapters 2, 3 and 5 do not align with those Chapters' headings, although it may not be intended that they should.

cl 2 Overview of Chapter (2)

17. **sc (1)** Should there also be a signpost to clause 11 (referring to the possible treatment of trade losses as CGT losses)?
18. **sc (4)** We note the use of the words 'by implication'; but it would be clearer to specifically list as exceptions those clauses which do not apply to professions and vocations.

cl 11 Treating trade losses as CGT losses

19. **sc (1)** With reference to Explanatory Notes paragraph 46, it will not be obvious to the reader that 'the unused part' of a trade loss can include the whole of that loss.

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20. **cl 12 Relief for individuals for losses in first 4 years of trade**
sc (4) Should there also be a signpost to clause 13 (How relief works)?
21. **cl 14 Restrictions on relief unless trade is commercial etc**
sc (1), (2) Is it made sufficiently clear that the sub-clause (2) tests apply to the period in which the loss was made? Sub-clause (1) might be read as applying to any period in which early trade losses might be given. The source s 381(4) ICTA specifically relates to the period in which the loss is sustained.
22. **cl 17 First-year allowances: partnerships with companies**
sc (6) We have no objection to arrangements including effecting schemes, whereas s 384A(2)(b) distinguishes ‘a scheme’ from ‘arrangements’. As s 384A(2)(b) (Restriction of set-off of allowances against general income) applies to both, nothing appears to turn on this. We appreciate that this form of drafting is necessary to make the ‘planned to be carried on’ approach in clause 17(1)(b) and (3) work.
23. Similarly, clause 18 (First-year allowances: tax avoidance schemes) is drafted by reference to ‘arrangements’ including the effecting of schemes (as is clause 34(5) (Dealings in commodity futures) and this is also unobjectionable.
24. **cl 23 Business transferred to a company**
sc (2) S 386(1) ICTA treats the individual for loss relief purposes as continuing to derive profits from the business, being the income which he actually derives from the company. In this context the drafting of clause 23(2)(a) is a little confusing, as it directs that such income is to be treated as included in ‘the profits of the business’ which is of course carried on by the company. Perhaps a change of wording in clause 23(2)(a) to ‘profits of the business accruing to the individual’, or some such, and drop the introductory words ‘included in -’ and sub-clause 23(2)(b)?
25. **cl 24 Carry forward of certain interest as loss**
sc (1)(a) S 390(a) ICTA does not specify the types of interest payment eligible for relief under s 353 ICTA (which applies to ss 359 – 365 ICTA) which constitute money wholly and exclusively laid out or expended for the purposes of a Schedule D 1/11 trade, profession or vocation; whereas clause 24(1)(a) restricts interest payments to those eligible by virtue of s 359 ICTA (Loan to buy machinery or plant) or s 362 ICTA (Loan to buy into partnership). We agree this restriction.
26. **cl 28 How relief works**
Clause 28 is a lengthy rewrite of the short s 388(3) ICTA (Carry-back of terminal losses); but we appreciate that the intention is to spell out the manner of giving relief, against a later before an earlier tax year’s profits within the four tax year period.
27. **cl 33 Ring fence trades: carry-forward trade loss relief**
sc (1) We are a little uneasy with the drafting of clause 33 (1). The approach in s 492(4) ICTA, that the ‘related activities’ would constitute a single trade together with the ring-fenced activities, emphasises the ‘single trade’ concept and is more comprehensible than the clause 33(1)(c) approach that the ‘other activities ... would be part of the trade’. Intelligibility essentially centres on how ‘other activities’ differ from ‘the oil-related activities’, but can nevertheless be regarded together as a single

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trade, and to clarify its intent clause 33 probably requires at least a reference to the definition of oil-related activities in s 15(2) ITTOIA.

cl 34 Dealings in commodity futures

28. **sc (1)(d)** The rewrite introduces the concept of ‘sole or main purpose’, which is then defined in clause 34(3). The source legislation in s 399(2)(b) refers to ‘sole or main benefit’. The application of clause 34 shifts from a basis of expectation to one of intention. Is it appropriate to make this change, or should clause 34(1)(d) be rewritten on a ‘sole or main benefit’ basis with clause 34 (3) then dropping out?

cl 35 Foreign trades: relief only against foreign income

29. **sc (1)(c)** In Explanatory Notes paragraph 94, it would be helpful to clarify the first sentence by stating that the commercial occupation of land outside the UK is not treated as the carrying on of a trade except where clause 10 of ITTOIA applies. The second sentence then excludes relief for losses arising to foreign clause 10 ITTOIA concerns.

Sch 1 Consequential Amendments

30. In s 261A(2), it may be clearer to move ‘(“the relevant amount”)’ into the second line after ‘loss’. This term refers to both clause 261A(2)(a) and (b), whereas in its present location it could be read as referring to s 261A(2)(b) only.

D DETAILED COMMENTS ON DRAFTING

Overview

31. In Explanatory Notes paragraph 1, the reference should be to s 379A and not to 397A of ICTA.

cl 10 Whether trade is the same trade

32. In Explanatory Notes paragraph 44, in the third line, a full stop is required after ‘person’.

cl 45 Treating loss in employment or office as CGT loss.

33. In Explanatory Notes paragraph 118, in the second line, ‘trade’ (loss relief) should be ‘employment’.

Sch 1 Consequential amendments

34. In Change {jc 413}: Claims for set-off of trading losses and employment losses against capital gains: clauses 11 and 45, in the fourth line, insert ‘of’ before ‘any’ (unutilised part of that loss).

14-13-36
TJH/PCB
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