Draft Regulations laid before the House of Commons under section 118ZN(5) of the Income and Corporation Taxes Act 1988 and section 122A(5) of the Finance Act 2004, for approval by resolution of the House of Commons.

DRAFT STATUTORY INSTRUMENTS

2005 No.

INCOME TAX

The Partnerships (Restrictions on Contributions to a Trade) Regulations 2005

Made - - - -	*2005*
Coming into force - -	*22nd July 2005*

A draft of this instrument has been laid before the House of Commons in accordance with section 118ZN(5) of the Income and Corporation Taxes Act 1988(**1**) and section 122A(5) of the Finance Act 2004(**2**) and approved by a resolution of the House of Commons.

Accordingly, the Commissioners for Her Majesty's Revenue and Customs, in exercise of the powers conferred by section 118ZN(2) to (4) of the Income and Corporation Taxes Act 1988 and section 122A(2) to (4) of the Finance Act 2004(**3**), make the following Regulations:

Citation, commencement and effect

1.—(1) These Regulations may be cited as the Partnerships (Restrictions on Contributions to a Trade) Regulations 2005 and shall come into force on 22nd July 2005.

(2) These Regulations shall have effect from 2nd December 2004.

Interpretation

2. In these Regulations—

"any other person", in relation to an individual, includes a partnership of which the individual is a member;

"arrangement" means any scheme, arrangement or understanding of any kind (whether or not it is, or is intended to be, legally enforceable);

(**1**) 1988 c. 1; section 118ZN was inserted by section 73(1) of the Finance Act 2005 (c. 7).
(**2**) 2004 c. 12; section 122A was inserted by section 79(1) of the Finance Act 2005.
(**3**) The functions of the Commissioners of Inland Revenue were transferred to the Commissioners for Her Majesty's Revenue and Customs by section 5(2) of the Commissioners for Revenue and Customs Act 2005 (c. 11).

"bank" has the meaning given by section 840A of ICTA(**4**);

"contribution to the relevant trade"—

(a) for the purposes of section 118ZN of ICTA, has the meaning in that section, and

(b) for the purposes of section 119 FA 2004, means the capital contribution to the relevant trade;

"events" includes an omission to exercise a right;

"FA 2004" means the Finance Act 2004;

"ICTA" means the Income and Corporation Taxes Act 1988;

"loan" includes—

(a) an advance of money, or any form of credit and "takes out a loan" shall be construed accordingly; and

(b) except in regulation 4(4)(a), any loan which, directly or indirectly, replaces the original loan (and so on, through any number of such loans);

"repaying", where the context requires, includes part repayment.

Scope of these Regulations

3. These Regulations apply for the purposes of—

(a) the relevant provisions mentioned in section 118ZN of ICTA, and

(b) except in regulation 5, applying section 119 FA 2004 as mentioned in section 122A(2) of that Act,

in computing the amount of an individual's contribution to the relevant trade.

Restrictions on computing the amount of an individual's contribution to a trade - Loans

4.—(1) This regulation applies where—

(a) an individual takes out a loan in connection with his financing of the whole or part of a contribution to the relevant trade, and

(b) at least one of the following conditions is satisfied.

Condition 1

There is, at any time an agreement or arrangement, under which all or any of the financial cost of repaying the loan is, will or may be borne, or ultimately borne, by any other person.

Condition 2

All or any of the financial cost of repaying the loan is at any time borne, or ultimately borne, by any other person (except under the terms of an agreement or arrangement falling within Condition 1).

Condition 3

The liability to repay the loan is at any time assumed or released by any other person.

Condition 4

The actual financial cost which the individual incurs in repaying the loan during a period mentioned in paragraph (4) is substantially less than what the financial cost to him would be on arm's length repayment terms (those costs being determined in accordance with paragraphs (3) and (4)), or is nil.

(**4**) Section 840A was inserted by paragraph 1(1) of Schedule 37 to the Finance Act 1996 (c. 8) and amended by paragraph 36 of Schedule 35 to the Finance Act 2004 (c. 12), Articles 13 and 46 of S.I. 2001/3629 and Article 2(1) and (2) of S.I. 2002/1409.

(2) Where any of Conditions 1 to 3 are satisfied, there shall be excluded when computing the amount of the individual's contribution to the relevant trade at the time in question the financial cost of repaying the loan, which is, will or may be borne or ultimately borne by the other person, or the liability to repay which is assumed or released by the other person, as the case may be.

(3) In determining the financial cost on arm's length repayment terms—

(a) the actual amount of the loan shall be taken into account,

(b) it shall be assumed that the individual repays the loan personally (without recourse to any other person or fund), and

(c) the rate of interest, period of the loan, repayment terms and other terms of the loan shall be assumed to be such that might be expected to be applicable if the loan were made—

(i) by a bank in the ordinary course of its lending business, and

(ii) by way of a bargain made at arm's length.

(4) The comparison required by Condition 4 shall be carried out over five year periods, and computations shall be made to determine the earliest such period—

(a) beginning on or after 2nd December 2004 (or the date when the loan was taken out, if later) and

(b) for which Condition 4 is satisfied.

The end of that period is referred to in paragraph (5) as "the relevant time".

(5) Where Condition 4 is satisfied, there shall be excluded when computing the amount of the individual's contribution to the relevant trade at the relevant time the capital liability outstanding under the loan at the relevant time, whether due from the individual or any other person or fund.

Restrictions on computing the amount of an individual's contribution to a trade – reimbursements

5.—(1) Where there is, at any time, an agreement or arrangement, under which all or any of the financial cost of making a contribution to the relevant trade will or may be directly or indirectly reimbursed to the individual by any other person, paragraph (3) shall apply.

(2) Where, at any time, all or any of the financial cost of making a contribution to the relevant trade is directly or indirectly reimbursed to the individual by any other person (except under the terms of an agreement or arrangement falling within paragraph (1)), paragraph (3) shall apply.

(3) There shall be excluded when computing the amount of the individual's contribution to the relevant trade at the time in question the financial cost of making the contribution which is, will or may be directly or indirectly reimbursed by the other person, as the case may be.

6. No amount shall be excluded from the computations more than once, and the following shall not be excluded when computing the amount of the individual's contribution to the relevant trade—

(a) any financial cost which is borne or reimbursed by another individual in the normal course of that individual's domestic, family or personal relationships;

(b) any loan repayments not made by the individual due to his financial inability to pay, arising as a result of events outside his control which occur after the loan was taken out; and

(c) any amount on which the individual is chargeable to income tax as profits of the trade.

Two of the Commissioners for Her Majesty's

2005 Revenue and Customs

EXPLANATORY NOTE

(This note is not part of the Regulations)

Sections 117, 118ZB and 118ZE of the Income and Corporation Taxes Act 1988 contain restrictions on the extent to which limited partners, members of a limited liability partnership and non-active partners can set off their share of a partnership's trading losses against their other income or gains (commonly called "sideways loss relief"). The restrictions are (broadly) that losses are restricted to the individual's capital contribution to the relevant trade. Section 119 of the Finance At 2004 imposes a charge to income tax where an individual has claimed film related losses in excess of his capital contribution to the trade. Sections 73 and 79 of the Finance Act 2005 supplement these provisions by giving the Commissioners of Inland Revenue a regulatory power to exclude amounts of any description specified in the regulations when computing the individual's capital contribution to the trade.

These Regulations exclude amounts in two situations.

The first is where the individual takes out a loan to finance a contribution to a trade, and the loan is on limited or non-recourse terms, or in the event, the cost of repaying the loan is borne, assumed or released by someone else (see Conditions 1 to 3 in regulation 4). There is a backup test whether the individual's loan repayment costs over any period of 5 years are less than they would be on arm's length commercial terms (see Condition 4 in regulation 4).

The second is where arrangements are made so that the financial cost to the individual of making a contribution to a trade can be reimbursed by someone else (see regulation 5).

Regulation 1 provides for citation, commencement and effect. The powers to make the retrospective provision made by Regulation 1(2) are conferred by section 118ZN(3)(a) of the Income and Corporation Taxes Act 1988 and section 122A(3)(a) of the Finance Act 2004.

Regulation 2 provides for interpretation.

Regulation 3 provides for the scope of the Regulations.

Regulation 4 provides for restrictions on computing the amount of an individual's contribution to a trade in the case where a loan is taken out to finance the whole or part of that contribution.

Regulation 5 provides for restrictions on computing the amount of an individual's contribution to a trade, where the financial cost of making that contribution is reimbursed (or agreed to be reimbursed) by someone else.

Regulation 6 provides for exemptions from the rules in regulations 4 and 5. These exemptions are where financial costs are met by another person in the normal course of personal relationships, where an individual becomes unable to pay them, or where the costs borne by another person are taxed as income of the individual.

A Regulatory Impact Assessment has not been produced for these Regulations as they are part of anti-avoidance rules which simply ensure that existing legislation is applied in the way that was intended by Parliament and it is not anticipated that they will affect those individuals that make genuine business losses.