

# INCOME TAX ACT 2007

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

#### Part 4: Loss relief

##### Overview

#### *Chapter 3: Restrictions on trade loss relief for certain partners*

##### Overview

331. This Chapter sets out restrictions on trade loss relief that apply in certain cases where an individual carries on a trade as a member of a partnership. The restrictions do not apply to persons other than individuals, or in relation to professions.
332. The main restrictions are on deducting trading losses from income (other than income from the trade) or capital gains. Broadly, the amount of such deductions must not exceed the amount that the individual stands to lose commercially.
333. In various places, source legislation expresses the amount that a partner stands to lose commercially by reference to the partner's contribution to the trade that a partnership carries on (the "contribution to the trade"). But, in such cases, the amount that a partner stands to lose commercially is more likely to be reflected in the partner's contribution to the partnership that carries on the trade.
334. So this Chapter, and Chapter 5 of Part 13 (avoidance involving trading losses), makes a change by expressing the amount that a partner stands to lose commercially in terms of the partner's contribution to the partnership (the "contribution to the firm"). The change to contribution to the firm requires that the possibility of there being partnerships with more than one trade is addressed by the change. And for consistency with other partnerships, the possibility of a limited liability partnership carrying on more than one trade is also addressed. This change affects many sections in this Chapter and it also makes a number of other clarifications as to what is included in a partner's contribution. See *Change 16* in Annex 1.

#### *Section 102: Overview of Chapter*

335. This section introduces the Chapter. It is new.
336. *Subsection (1)* is a signpost to the main restrictions, which apply in certain cases where the individual is a limited partner, a member of a limited liability partnership or a non-active partner.
337. *Subsection (2)* is a signpost to a further restriction applying where the trade consists of or includes the exploitation of films.
338. *Subsections (3)* and *(4)* provide signposts to sections in Chapter 5 of Part 13 (avoidance involving trading losses).

***Section 103: Meaning of “sideways relief”, “capital gains relief” and “firm”***

- 339. This section defines these terms. It is new.
- 340. The definition of “capital gains relief” refers to section 261B of TCGA, which is inserted by Schedule 1 to this Act.

***Section 104: Restriction on reliefs for limited partners***

- 341. This section restricts the use of a trade loss made in a tax year by an individual carrying on the trade as a limited partner. It is based on section 117(1) and (2) of ICTA.
- 342. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual’s contribution to the firm.
- 343. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit. See *Change 13* in Annex 1.
- 344. The individual’s contribution to the firm is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.
- 345. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on this Chapter and *Change 16* in Annex 1.

***Section 105: Meaning of “contribution to the firm”***

- 346. This section sets out details of what is included in determining the contribution to the firm. It is based on section 117(3) and (5) of ICTA.
- 347. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on this Chapter and *Change 16* in Annex 1.
- 348. The individual’s contribution of capital to the firm is reduced by any amounts drawn out or received back. *Subsection (5)* provides an exception. The exception is for an amount drawn out or received back which is treated as income chargeable to income tax. This exception is similar to the one in section 111(5), based on section 118ZG(5) of ICTA. See *Change 17* in Annex 1.

***Section 106: Meaning of “limited partner”***

- 349. This section defines “limited partner”. It is based on section 117(2) of ICTA.
- 350. A limited partner of a limited partnership registered under the Limited Partnerships Act 1907 is someone who is not entitled to take part in the management of the firm’s business and is not liable for the debts or obligations of the firm beyond a certain limit. And a limited partner of any other firm is someone who is similarly not entitled to take part in management and not liable for debts or obligations in accordance with the rules applying to the firm in question.
- 351. *Subsection (4)* is introduced as part of drafting in terms of an individual’s “contribution to the firm” in place of “contribution to the trade”. See *Change 16* in Annex 1.

***Section 107: Restriction on reliefs for members of LLPs***

- 352. This section restricts the use of a trade loss made in a tax year by an individual carrying on a trade as a member of a limited liability partnership (LLP). It is based on sections 117(1) and (2) and 118ZB(1) and (2) of ICTA.
- 353. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual’s “contribution to the LLP”.

*These notes refer to the Income Tax Act 2007 (c.3)  
which received Royal Assent on 20 March 2007*

- 354. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit. See *Change 13* in Annex 1.
- 355. The individual's contribution to the LLP is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.
- 356. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.

### ***Section 108: Meaning of "contribution to the LLP"***

- 357. This section sets out details of what is included in determining the contribution to the LLP. It is based on sections 118ZB(1) and 118ZC of ICTA.
- 358. An LLP formed under the Limited Liability Partnerships Act 2000 is an entity with separate legal personality. That Act defines what is meant by contribution to the limited liability partnership.
- 359. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.
- 360. The individual's contribution of capital to the LLP is reduced by any amounts drawn out or received back. *Subsection (6)* provides an exception. The exception is for an amount drawn out or received back which is treated as income chargeable to income tax. This exception is similar to the one in section 111(5), based on section 118ZG(5) of ICTA. See *Change 17* in Annex 1.

### ***Section 109: Unrelieved losses brought forward***

- 361. This section specifies how the amount of any loss, which could not be relieved because of section 107, may be brought forward for use in a later tax year in which the individual continues to carry on the trade as a member of an LLP. It is based on sections 118ZD and 118ZM(8) of ICTA.
- 362. The section treats the unrelieved loss as a trading loss of the later tax year, unless it is an excluded loss (see *subsection (3)*).
- 363. The interaction between section 72 of FA 1991 and section 117 of ICTA is made explicit in section 107, to which this section refers. See *Change 13* in Annex 1.

### ***Section 110: Restriction on reliefs for non-active partners in early tax years***

- 364. This section restricts the use of trade losses made by an individual carrying on a trade as "a non-active partner" in an "early tax year". It is based on sections 118ZE and 118ZF of ICTA.
- 365. A non-active partner is an individual who does not devote a significant amount of time to the trade and is not a limited partner. See section 112.
- 366. Sideways relief or capital gains relief for the trade loss, combined with other relevant relief, must not exceed the individual's "contribution to the firm".
- 367. The restriction applies only to losses made in the first tax year in which the individual carries on the trade or in any of the next three tax years. See section 112(6).
- 368. The interaction between section 72 of FA 1991 and section 118ZE of ICTA is made explicit. See *Change 13* in Annex 1.

369. The individual's contribution to the firm is measured at the end of the basis period for the relevant tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.
370. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.
371. *Subsection (8)* disapplies the rules in the case of losses from a trade of underwriting at Lloyd's. Lloyd's underwriters are subject to a specific tax regime which reflects the nature of the business and the partners' liabilities for the underwriting losses.

### ***Section 111: Meaning of "contribution to the firm"***

372. This section sets out details of what is included in determining the individual's contribution to the firm. It is based on section 118ZG of ICTA.
373. There is a change from "contribution to the trade" in the source legislation to "contribution to the firm". See the overview commentary on this Chapter and *Change 16* in Annex 1.
374. The definition differs slightly from the definition of "contribution to the firm" for limited partners. The definition for a non-active partner includes a reference to any additional amount contributed on a winding-up, whereas the definition for a limited partner includes no such reference, as a limited partner is under no obligation to contribute any amounts beyond the amount originally agreed as the required contribution.

### ***Section 112: Meaning of "non-active partner" and "early tax year" etc***

375. This section sets out details of who is carrying on a trade as a non-active partner in an early tax year. It is based on sections 118ZE, 118ZH and 118ZM of ICTA.
376. The definition excludes limited partners. So only a general partner (that is, a partner other than a limited partner) or a member of an LLP may be a non-active partner.
377. In broad terms, a non-active partner is an individual who does not devote a significant amount of time to the trade and is, therefore, unlikely to be anything more than a financial investor.
378. *Subsection (2)* provides that a significant amount of time is taken as being a minimum of ten hours per week, on average taken across the period.
379. *Subsections (3) and (4)* define the "relevant period" for the purposes of subsection (2) as the whole of the basis period for the tax year, or a continuous period of at least six months either beginning with the date of commencement or ending with the date of cessation. For example, if an individual commences a trade on 1 April 2007, the basis period for 2006-07 is 1 April 2007 to 5 April 2007. And the relevant period ends on 30 September 2007 for the purposes of this section in relation to the tax year 2006-07. So the individual must meet the "significant amount of time" test for six months rather than just for five days.
380. *Subsection (5)* provides that where relief is given but the activity rules prove not to be satisfied, relief is withdrawn by making an assessment under this section.

### ***Section 113: Unrelieved losses brought forward***

381. This section specifies how the amount of any loss, which could not be relieved because of section 110, may be brought forward for use in a later tax year in which the individual continues to carry on the trade as a partner (or contributes to the firm on its winding up). It is based on sections 118ZI and 118ZM of ICTA.

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- 382. The section treats the unrelieved loss as a trading loss of the later tax year unless it is an excluded loss (see *subsection (4)*).
- 383. The interaction between section 72 of FA 1991 and section 118ZE of ICTA is made explicit in section 110, to which this section refers. See *Change 13* in Annex 1.
- 384. The section reflects the contribution to the firm being measured at the end of the basis period for a tax year, rather than at the end of the tax year as in the source legislation. See *Change 15* in Annex 1.

***Section 114: Exclusion of amounts in calculating contribution to the firm or LLP***

- 385. This section enables regulations, which can apply on a retrospective basis, to exclude certain amounts from the calculation of the contribution to the firm or LLP. It is based on section 118ZN of ICTA.
- 386. Regulations made under this section are subject to the affirmative resolution procedure.
- 387. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on this Chapter and *Change 16* in Annex 1.
- 388. Some regulations have been made under section 118ZN of ICTA, with effect from 22 July 2005. See the [Partnerships \(Restrictions on Contributions to a Trade\) Regulations 2005 \(SI 2005/2017\)](#). See also the commentary on Part 5 of Schedule 2 about consequential amendments made to these regulations by this Act.
- 389. In *subsection (4)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See section 1018 and *Change 152* in Annex 1.

***Section 115: Restrictions on reliefs for firms exploiting films***

- 390. This section extends the restriction on the use of sideways relief and capital gains relief to (effectively) non-active partners carrying on a trade that exploits films, where there is a relevant agreement that guarantees the individual an amount of income. It is based on sections 118ZL and 118ZM of ICTA.
- 391. The interaction between section 72 of FA 1991 and section 118ZL of ICTA is made explicit. See *Change 13* in Annex 1.

***Section 116: Exclusion from restrictions under section 115: certain film expenditure***

- 392. This section specifies that the restriction under the previous section does not apply to the extent any loss qualifying for relief derives from unrestricted film expenditure. It is based on sections 118ZL and 118ZM of ICTA.