



Finance Act 2004

2004 CHAPTER 12

PART 3

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER 9

AVOIDANCE INVOLVING LOSS RELIEF OR PARTNERSHIP

Individuals in partnership: restriction of relief

124 Restriction of relief: non-active partners

(1) After section 118ZD of the Taxes Act 1988 there is inserted—

“Non-active general partners and non-active members of limited liability partnerships

118ZE Restriction on relief for non-active partners

- (1) This section applies to an amount which may be given to an individual under section 353, 380 or 381 in respect of a loss sustained by him in a trade, or interest paid by him in connection with the carrying on of a trade, in a qualifying year of assessment.
- (2) The amount may be given otherwise than against income consisting of profits arising from the trade only to the extent that—
 - (a) the amount given, or
 - (b) (as the case may be) the aggregate amount,does not exceed the amount of the individual's contribution to the trade as at the end of that year of assessment.

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- (3) A “qualifying year of assessment” means a year of assessment—
- (a) at any time during which the individual carried on the trade as a general partner or a member of a limited liability partnership,
 - (b) in which he did not devote a significant amount of time to the trade (within the meaning given by section 118ZH),
 - (c) which is the year of assessment in which the trade is first carried on by him or any of the next three years of assessment,
 - (d) the basis period for which ends on or after 10 February 2004, and
 - (e) which is not a year of assessment at any time during which he carried on the trade as a limited partner.
- (4) In this section—
- (a) a “general partner” means any partner who is not a limited partner, and
 - (b) “limited partner” has the meaning given by section 117(2),
- and in paragraph (a) “any partner” does not include a member of a limited liability partnership.
- (5) In this section and sections 118ZF to 118ZK, “basis period” means (subject to subsection (6)) the basis period given by sections 60 to 63 as applied by section 111(4) and (5).
- (6) The basis period for a year of assessment to which section 61(1) applies is to be taken for the purposes of this section and sections 118ZF to 118ZK to be the period beginning with the date when the individual first carried on the trade and ending with the end of the year of assessment.
- (7) In subsection (1) “a trade” does not include underwriting business within the meaning of section 184 of the Finance Act 1993 (Lloyd’s underwriters).
- (8) This section has effect subject to sections 118ZJ and 118ZK (transitional provision).

118ZF Meaning of “the aggregate amount”

- (1) In section 118ZE(2) “the aggregate amount” means (subject to section 118ZK) the aggregate of any amounts given to the individual at any time under section 353, 380 or 381 in respect of a loss sustained by him in the trade, or of interest paid by him in connection with carrying it on, in a year of assessment falling within subsection (2).
- (2) A year of assessment falls within this subsection if—
- (a) it is a qualifying year of assessment within the meaning of section 118ZE, or
 - (b) it is a year of assessment—
 - (i) at any time during which the individual carried on the trade as a member of a limited liability partnership or as a limited partner within the meaning given by section 117(2), and
 - (ii) the basis period for which ends on or after 10 February 2004.

118ZG “The individual’s contribution to the trade”

- (1) For the purposes of section 118ZE(2), the individual’s contribution to the trade at any time (“the relevant time”) is the sum of—
 - (a) the amount subscribed by him,
 - (b) the amount of any profits of the trade to which he is entitled but which he has not received in money or money’s worth, and
 - (c) where there is a winding up, the amount that he has contributed to the assets of the partnership on its winding up.
- (2) For the purposes of subsection (1)(a) the “amount subscribed” by an individual is the sum of—
 - (a) the total amount (if any) contributed by him to the trade as capital on or after 10 February 2004, reduced (but not below nil) by his withdrawn capital, and
 - (b) the total amount (if any) contributed by him to the trade as capital before 10 February 2004, reduced (but not below nil) by—
 - (i) the pre-announcement allowance (within the meaning given by section 118ZJ),
 - (ii) the aggregate of any amounts given to him at any time under section 353, 380 or 381 in respect of a loss sustained by him in a trade, or of interest paid by him in connection with carrying it on, in a year of assessment falling within subsection (3), and
 - (iii) the amount (if any) of his withdrawn capital that has not been used in the reduction to nil required by paragraph (a).
- (3) A year of assessment falls within this subsection if—
 - (a) it does not fall within section 118ZE(3)(d), and
 - (b) it is either—
 - (i) a year of assessment that would be a qualifying year of assessment but for section 118ZE(3)(d), or
 - (ii) a year of assessment at any time during which the individual carried on the trade as a member of a limited liability partnership or as a limited partner within the meaning given by section 117(2).
- (4) The individual’s “withdrawn capital” is so much, if any, of the amount that he has contributed to the trade as capital as—
 - (a) he has previously, directly or indirectly, drawn out or received back,
 - (b) he so draws out or receives back during the period of five years beginning with the relevant time,
 - (c) he is or may be entitled so to draw out or receive back at any time when he carries on the trade as a member of the partnership, or
 - (d) he is or may be entitled to require another person to reimburse to him.
- (5) An amount drawn out or received back that would otherwise fall within subsection (4)(a) or (b), or an entitlement that would otherwise fall within subsection (4)(c), shall be treated as not so falling if the amount drawn out or received back is chargeable to income tax as profits of the trade.

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- (6) In relation to a member of a limited liability partnership, references in this section to an amount contributed to the trade as capital shall be read as references to an amount contributed to the limited liability partnership as capital.

118ZH “A significant amount of time”

- (1) For the purposes of section 118ZE the individual shall be treated as having “devoted a significant amount of time to the trade” in a given year of assessment if, for the whole of the relevant period, he spent an average of at least ten hours a week personally engaged in activities carried on for the purposes of the trade.
- (2) “The relevant period” means the basis period for the year of assessment in question, except that—
- (a) if the basis period is less than six months and begins with the date when the individual first carried on the trade, “the relevant period” means six months beginning with that date, and
 - (b) if the basis period is less than six months and ends with the date when the individual ceased to carry on the trade, “the relevant period” means six months ending with that date.
- (3) Where relief has been given on the assumption that an individual will meet the condition in subsection (1) and he fails to do so, the relief shall be withdrawn by the making of an assessment under Case VI of Schedule D.

118ZI Carry forward of unrelieved losses of non-active partners

- (1) Where amounts relating to a trade carried on by an individual in a qualifying year of assessment are prevented from being given by section 118ZE as it applies otherwise than by virtue of this section or section 118ZD, subsection (3) of this section applies as respects each subsequent year of assessment in which—
- (a) the individual carries on the trade in partnership or makes a contribution to the assets of the partnership on its winding up, and
 - (b) any of his total restricted loss remains outstanding.
- (2) His “total restricted loss” means the total of any amounts, relating to any one or more qualifying years of assessment, that have been prevented from being given by section 118ZE as it applies otherwise than by virtue of this section or section 118ZD.
- (3) Sections 380 and 381 (and section 118ZE as it applies in relation to those sections) shall have effect in the subsequent year of assessment as if—
- (a) any loss sustained by the individual in the trade in that year of assessment were increased by an amount equal to so much of his total restricted loss as remains outstanding in that year of assessment, or
 - (b) (if no loss is sustained) a loss of that amount were so sustained.
- (4) To ascertain whether any (and, if so, how much) of the individual’s total restricted loss remains outstanding in the subsequent year of assessment, deduct from the amount of his total restricted loss the aggregate of—

- (a) any relief given (otherwise than as a result of subsection (3)) under any provision of the Tax Acts, in that or any previous year of assessment, in respect of any of his total restricted loss, and
 - (b) any amount which was given as a result of subsection (3), in any previous year of assessment, in respect of any of his total restricted loss (or which would have been so given had a claim been made).
- (5) For the purposes of sections 118ZE and 118ZF (and of sections 117 and 118ZB(2))—
 - (a) any additional amount of loss deemed by subsection (3)(a) to have been sustained in the subsequent year of assessment, and
 - (b) any loss deemed by subsection (3)(b) to have been so sustained,shall be treated as having been sustained in a qualifying year of assessment.
- (6) Subsection (7) applies where the subsequent year of assessment—
 - (a) is one in which the trade is not carried on in partnership by the individual, but
 - (b) is one in which he contributes to the assets of the partnership on its winding up.
- (7) Where this subsection applies, nothing in section 381(4) or 384 (restrictions on right of set-off) applies to—
 - (a) an additional amount of loss deemed by subsection (3)(a) to have been sustained in the subsequent year of assessment, or
 - (b) a loss deemed by subsection (3)(b) to have been so sustained.
- (8) In this section “qualifying year of assessment” has the meaning given by section 118ZE.

18ZJ Commencement: the first restricted year

- (1) This section applies where the year of assessment referred to in section 118ZE(1) is a year of assessment the basis period for which includes 10 February 2004 (“the first restricted year”).
- (2) If this section would (but for this subsection) apply in relation to more than one year of assessment as respects the same individual and the same trade, it applies only in relation to the first of those years of assessment and “the first restricted year” means that year of assessment.
- (3) Where this section applies, section 118ZE(2) shall have effect as if for the words from “only to the extent that” there were substituted “only to the extent that the total amount given under section 353, 380 and 381 in respect of losses sustained by him in the trade, and interest paid by him in connection with carrying it on, in that year of assessment does not exceed the sum of—
 - (a) the pre-announcement allowance, and
 - (b) the post-announcement allowance.”
- (4) The “pre-announcement allowance” is the sum of—
 - (a) the loss (if any) sustained by the individual in the trade in the period beginning with the start of the basis period for the first restricted year and ending with 9 February 2004, and

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- (b) any interest paid by him in that period in connection with the carrying on of the trade.
- (5) The “post-announcement allowance” is so much of—
- (a) the loss (if any) sustained by the individual in the trade in the period beginning with 10 February 2004 and ending with the end of the basis period for the first restricted year, and
 - (b) any interest paid by him in that period in connection with the carrying on of the trade,
- as does not exceed the individual’s contribution to the trade as at the end of the year of assessment, computed in accordance with section 118ZG.
- (6) In each of subsections (4)(a) and (5)(a), the reference to the loss sustained by the individual in the trade in the period there mentioned is a reference to his share of any losses of the partnership arising for that period from the trade, and—
- (a) subject to subsection (7), the losses of the partnership arising for that period from the trade shall be computed in the same way as if the period were one for which profits and losses had to be computed for the purposes of section 111(2), and
 - (b) subject to subsection (8), the individual’s share of the losses shall be determined according to his interest in the partnership during that period.
- (7) In computing for the purposes of subsection (6) the losses of the partnership arising for the period mentioned in subsection (4)(a) or (5)(a)—
- (a) any capital allowance treated as an expense of the trade for the purposes of the computation required by section 111(2) for the first restricted year is to be regarded as belonging to the period mentioned in subsection (4)(a) unless the capital expenditure to which it relates is incurred after 9 February 2004, and
 - (b) any amount deducted under section 42(1) of the Finance (No. 2) Act 1992 for the purposes of that computation is to be regarded as belonging to the period mentioned in subsection (4)(a) unless the expenditure to which it relates is incurred after 9 February 2004.
- (8) If the individual had an interest in the partnership at any time that falls within—
- (a) the basis period for the first restricted year, and
 - (b) the period beginning with 10 February 2004 and ending with 25 March 2004,
- he shall be deemed for the purposes of subsection (6)(b) to have had the interest on 9 February 2004.

118ZK Transitional provision for years after the first restricted year

- (1) This section applies where the year of assessment referred to in section 118ZE(1) is a year of assessment later than the first restricted year.
- (2) Section 118ZE(2) shall not apply to any part of the amount mentioned in section 118ZE(1) that—

- (a) derives from a capital allowance treated as an expense of the trade where the capital expenditure to which the allowance relates was incurred before 10 February 2004, or
 - (b) derives from a deduction made under section 42(1) of the Finance (No. 2) Act 1992 where the expenditure to which the deduction relates was incurred before 10 February 2004.
- (3) In computing for the purposes of section 118ZE(2)(a) or (b) the amount given or (as the case may be) the aggregate amount, any part of an amount given that falls within subsection (2)(a) or (b) of this section shall be left out of account.
- (4) In computing the aggregate amount for the purposes of section 118ZE(2), any amount given in respect of the pre-announcement allowance shall be left out of account.
- (5) For the purposes of subsections (2) and (3) the part of an amount that derives from a capital allowance or a deduction made under section 42(1) of the Finance (No. 2) Act 1992 shall be determined on such basis as is just and reasonable.
- (6) In this section “the first restricted year” and “the pre-announcement allowance” have the meanings given by section 118ZJ.”
- (2) In section 117(2) of the Taxes Act 1988, in paragraph (a) of the definition of “the aggregate amount”, after “a relevant year of assessment” there is inserted “or a qualifying year of assessment within the meaning of section 118ZE”.
- (3) Section 118ZB of the Taxes Act 1988 (restriction on relief: members of limited liability partnerships) is renumbered as subsection (1) of that section and after that provision there is added—
 - “(2) However, section 117 does not apply in relation to a loss sustained by an individual in a trade, or interest paid by him in connection with the carrying on of a trade, in a qualifying year of assessment within the meaning of section 118ZE.”
- (4) In section 118ZD of the Taxes Act 1988 (carry forward of unrelieved losses by members of limited liability partnerships), in subsection (2), for “and 118” there is substituted “, 118 and 118ZE”.