



**HM Revenue
& Customs**

Sideways Loss Relief: Tax - Generated Losses

Draft Legislation, Explanatory Note and Technical Guidance
21 October 2009

Contents

Page

Introduction	3
Draft Legislation	4
Explanatory Note	7
Technical Guidance	10

Introduction

The Government announced action today, 21 October 2009, to counter avoidance that relies on using sideways loss relief. This document contains the draft legislation, explanatory note and guidance for this measure.

For further details about this change please contact:

Mark Anderson
HM Revenue & Customs
Mailstation A, 3rd Floor
100 Parliament Street
London
SW1A 2BQ
Tel: 020 7147 2621
Email: mark.anderson@hmrc.gsi.gov.uk

Draft Legislation

This section contains the draft legislation.

Finance Bill

1

1 Sideways relief etc: anti-avoidance

The Schedule contains provision denying sideways relief etc for tax-generated losses.

SCHEDULE

Section 1

SIDEWAYS RELIEF ETC: ANTI-AVOIDANCE

Amendments of Chapter 2 of Part 4 of ITA 2007

- 1 Chapter 2 of Part 4 of ITA 2007 (trade losses) is amended as follows.
- 2 In section 60(1)(c) (overview of Chapter), for “(see sections 75” substitute “and capital gains relief (see sections 74ZA”.
- 3 In section 64(8) (deduction of losses from general income) –
 - (a) in paragraph (ba), for “74A” substitute “74ZA”,
 - (b) at the end of paragraph (c), insert “and”, and
 - (c) omit paragraph (e).
- 4 In section 72(5) (relief for individuals for losses in first 4 years of trade) –
 - (a) in paragraph (ba), for “74A” substitute “74ZA”,
 - (b) at the end of paragraph (c), insert “and”, and
 - (c) omit paragraph (e).
- 5 Before section 74A insert –

“74ZA No relief for tax-generated losses⁴”

- (1) This section applies if –
 - (a) during a tax year a person carries on (alone or in partnership) a trade, profession or vocation (“the relevant activity”),
 - (b) the person makes a loss in the relevant activity in that tax year, and
 - (c) the loss arises directly or indirectly in consequence of, or otherwise in connection with, relevant tax avoidance arrangements.
- (2) No sideways relief or capital gains relief may be given to the person for the loss (but subject to subsection (5)).
- (3) In subsection (1) “relevant tax avoidance arrangements” means arrangements –
 - (a) to which the person is a party, and
 - (b) the main purpose, or one of the main purposes, of which is the obtaining of a reduction in tax liability by means of sideways relief or capital gains relief.
- (4) In subsection (3) “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).
- (5) This section has no effect in relation to any loss that derives wholly from qualifying film expenditure (see section 74D).
- (6) For the purposes of this section –

- (a) capital gains relief is, in relation to a loss, the treatment of a loss as an allowable loss by virtue of section 261B of TCGA 1992 (use of trading loss as a CGT loss), and
 - (b) capital gains relief is given for a loss when it is so treated.”
- 6 Omit section 74B (no relief for tax-generated losses in case of non-active individuals carrying on trade).
- 7 (1) Section 74C (meaning of “non-active capacity” for purposes of sections 74A and 74B etc) is amended as follows.
 - (2) In subsection (1), for “sections 74A and 74B” substitute “section 74A”.
 - (3) In the heading, for “**sections 74A and 74B**” substitute “**section 74A**”.
- 8 (1) Section 74D (meaning of “qualifying film expenditure” for purposes of sections 74A and 74B) is amended as follows.
 - (2) In subsections (1) and (4), for “74A and 74B” substitute “74ZA and 74A”.
 - (3) In the heading, for “**74A and 74B**” substitute “**74ZA and 74A**”.
- 9 Omit section 81 (dealings in commodity futures).

Other amendments

- 10 In FA 2009, in Schedule 6, in paragraph 1(11) –
 - (a) in paragraph (b), for “74B” substitute “74ZA”,
 - (b) at the end of paragraph (c), insert “and”, and
 - (c) omit paragraph (e) (and the “and” before it).

Commencement

- 11 (1) The amendments made by this Schedule have effect in relation to a loss if it arises directly or indirectly in consequence of, or otherwise in connection with –
 - (a) arrangements which are entered into on or after 21 October 2009, or
 - (b) any transaction forming part of arrangements which is entered into on or after that date.
- (2) But those amendments do not have effect where the arrangements are, or any such transaction is, entered into pursuant to an unconditional obligation in a contract made before that date.
- (3) “An unconditional obligation” means an obligation which may not be varied or extinguished by the exercise of a right (whether or not under the contract).

Draft Explanatory Note

This section contains a draft explanatory note for the draft legislation.

DRAFT EXPLANATORY NOTE

SIDEWAYS RELIEF ETC: ANTI-AVOIDANCE

SUMMARY

1. This clause and Schedule provide changes to the rules for “sideways loss relief” claimable by a person who makes a loss in a trade, profession or vocation. These rules are designed to prevent tax-generated losses from being offset against the person’s other taxable income or capital gains. These changes were announced on 21 October 2009 and will apply on and after that date.

DETAILS OF THE SCHEDULE

2. Paragraph 1 amends Chapter 2 of Part 4 of the Income Tax Act 2007 (ITA).
3. Paragraph 2 adds a reference to “capital gains relief” in section 60(1)(c) of ITA in the overview of Chapter 2.
4. Paragraphs 3 and 4 make consequential amendments in sections 64(8) and 72(5) of ITA respectively relating to the introduction of new section 74ZA of ITA and the repeal of section 81 of ITA.
5. Paragraph 5 inserts new section 74ZA (No relief for tax-generated losses).
6. Section 74ZA(1) provides that this section applies if a person makes a loss in a tax year from carrying on a trade, profession or vocation, either in a sole capacity or as a partner, and that loss arises directly or indirectly in consequence of, or otherwise in connection with, relevant tax avoidance arrangements (as defined in section 74ZA(3)).
7. Section 74ZA(2) provides that no sideways relief or capital gains relief may be given to the person for that loss (subject to subsection 5).

8. Section 74ZA(3) defines “relevant tax avoidance arrangements” as arrangements to which the person is a party and the main purpose, or one of the main purposes, of which is the obtaining of a reduction in tax liability by means of sideways relief or capital gains relief.
9. Section 74ZA(4) defines “arrangements” as including any agreement, understanding, scheme, transaction or series of transactions, whether or not legally enforceable.
10. Section 74ZA(5) provides that section 74ZA does not have any effect where a loss derives wholly from qualifying film expenditure (as defined in section 74D of ITA).
11. Section 74ZA(6) defines capital gains relief for the purpose of this section. The definition of sideways relief is in section 60(4) of ITA.
12. Paragraph 6 repeals section 74B of ITA.
13. Paragraphs 7 and 8 make consequential amendments to sections 74C and 74D of ITA relating to the repeal of section 74B of ITA.
14. Paragraph 9 repeals section 81 of ITA.
15. Paragraph 10 makes consequential amendments to Schedule 6 to Finance Act 2009 relating to the introduction of new section 74ZA of ITA and the repeal of section 81 of ITA.
16. Paragraph 11(1) provides that the amendments made by the Schedule have effect in relation to a loss if it arises directly or indirectly in consequence of, or otherwise in connection with, arrangements which are entered into on or after 21 October 2009, or any transaction forming part of the arrangements which is entered into on or after that date (subject to paragraph 11(2)).
17. Paragraph 11(2) provides that the amendments do not have effect where the arrangements are, or any such transaction is, entered into pursuant to an unconditional obligation in a contract made before 21 October 2009.

18. Paragraph 11(3) provides that an unconditional obligation is an obligation which may not be varied or extinguished by the exercise of any right conferred on the individual, whether or not under the contract.

BACKGROUND NOTE

19. A person who makes a loss in a trade, profession or vocation may claim for the loss to be offset against their other income and capital gains. This is commonly known as “sideways loss relief”.
20. Despite previous legislative action to deter those who seek to misuse the sideways loss relief rules the Government has continued to see evidence of avoidance activity that relies on the creation of contrived losses for use as sideways loss relief. This puts at risk substantial sums of tax.
21. The Financial Secretary to the Treasury (Stephen Timms) announced in a written statement on 21 October 2009 that legislation would be introduced with effect from that date to prevent sideways loss relief being given where the loss arises from arrangements and a main purpose of the arrangements is to obtain a tax reduction by means of sideways loss relief.

Draft Guidance

This section contains draft guidance on the draft legislation and is intended for inclusion in HMRC's Business Income Manual.

Trade losses: restriction of relief: tax-generated losses

- 1 ITA07/S74ZA is a targeted anti-avoidance measure which prevents any sideways relief or capital gains relief ("sideways loss relief") being given to a person for a loss from a trade, profession or vocation where the loss arises from tax avoidance arrangements.
- 2 The legislation is specifically targeted at persons who enter into tax avoidance arrangements with a main purpose of obtaining a tax reduction by way of sideways loss relief. It will have no relevance for the vast majority of taxpayers who do not enter into such arrangements.
- 3 The restriction applies to losses which arise as a result of tax avoidance arrangements entered into on or after 21 October 2009 (see paragraph 13 for the commencement rules).

Application

- 4 This restriction applies if:
 - a person makes a loss for a tax year from carrying on a trade, profession or vocation and
 - the loss arises directly or indirectly in consequence of, or otherwise in connection with, relevant tax avoidance arrangements.

Relevant tax avoidance arrangements

- 5 These are defined as arrangements to which the person is a party, and the main purpose, or one of the main purposes, of the arrangements is the obtaining of a reduction in tax liability by means of sideways loss relief.

Arrangements

- 6 The term "arrangements" is widely drawn and includes any agreement, understanding, scheme, transaction or series of transactions, whether or not legally enforceable.
- 7 Whether a transaction forms part of a series of transactions, or a scheme, or an arrangement is in general a question of fact but this conclusion will follow in any case where one transaction would not have taken place without another transaction, or would have taken place on different terms without that other transaction. However, it is not necessary that transactions must depend on each other in this way in order that they form part of a scheme or arrangement.

Obtaining of a reduction in tax liability

- 8 It is a condition for the legislation to apply that the main purpose, or one of the main purposes, of a person being party to the arrangement(s) is the obtaining of a reduction in tax liability by means of sideways loss relief.
- 9 The fact that a reduction in tax liability is an inevitable outcome if sideways loss relief is allowed does not mean that a main purpose of the taxpayer must be to obtain a tax advantage. In the case of the vast majority of taxpayers their purpose for entering into a transaction will be determined by commercial considerations and tax relief is an incidental consequence. However, in the case of an avoider the main purpose, or one of the main purposes, is always the securing of a tax advantage.
- 10 In applying this condition it is, therefore, necessary to consider the purpose of the person entering into the arrangements and the relevant circumstances. Factors to consider are:
- the overall economic objective: whether the transaction was inextricably linked to a core commercial activity and in a form not driven by considerations of tax advantage,
 - whether the objective is one which the parties involved might ordinarily be expected to have, and whether the transaction giving rise to the reduction in tax liability would have otherwise have taken place at all;
 - whether the objective of the arrangements is being fulfilled in a straightforward way or whether the introduction of any additional, complex or costly steps would have taken place were it not for the reduction in tax liability that could be obtained
 - whether the reduction in tax liability would have been of the same amount without the arrangements and whether the transaction would have been made under the same terms and conditions
 - whether the loss has arisen in connection with a marketed tax avoidance scheme.

Restriction of losses

- 11 Where ITA07/S74ZA applies no sideways loss relief may be given for the loss. It may, however, be carried forward against any profits of the same trade, profession or vocation.

Qualifying film expenditure

- 12 ITA07/S74ZA does not apply to qualifying film expenditure as defined in ITA07/S74D.

Commencement

- 13 ITA07/S74ZA applies in relation to a loss if it arises directly or indirectly in consequence of, or otherwise in connection with arrangements, or any transaction forming part of arrangements, which are entered into on or after 21 October 2009 unless the arrangements are, or any such transaction is, entered into under an unconditional obligation in a contract made before 21 October 2009.

Examples

- 14 Examples of how the legislation will apply in particular circumstances are set out below.

Example 1 – loss from a marketed tax avoidance scheme

- 15 Individual W is in employment and expects to receive a bonus of £250,000 that he wishes to shelter from tax. W enters into a scheme that is being marketed by a tax adviser under which arrangements are put in place to generate a contrived partnership loss through a series of transactions involving non-resident parties and circular loan finance. W's share of the contrived partnership losses is £250,000. W claims the loss for set-off against his employment and other income and seeks a repayment of tax.
- 16 The loss arises in consequence of relevant tax avoidance arrangements. To decide whether a main purpose of those arrangements is to obtain a reduction in tax liability by way of sideways loss relief it is necessary to look at all the circumstances in which the arrangements were entered into, including the participant's overall economic objective. In this case it is clear that a main purpose of Individual W entering into the arrangements was to obtain a reduction in tax liability by means of sideways loss relief. ITA/S74ZA therefore applies and no sideways loss relief is given for the loss.

Example 2 – loss arising to an individual from his trade

- 17 Individual X carries on a manufacturing business. He also has a large portfolio of property. This property business makes annual profits of £150,000. X incurs capital expenditure of £50,000 on new machinery for the manufacturing business funded by a bank loan on normal commercial terms. X anticipates that the expenditure will qualify for tax relief in the form of capital allowances.
- 18 Shortly after the machinery has been installed one of X's main customers goes into liquidation and defaults on payment. At the end of the tax year X has a trading loss of £100,000 which he claims for off-set against the profits from his property business.
- 19 The transactions giving rise to X's trading loss are ordinary trading transactions. Although X anticipated that the new machinery would qualify for Annual Investment Allowance this is incidental to his main purpose in acquiring the new machinery which is that it was needed for the operation of the business. X did not have a main purpose of accessing sideways loss relief and ITA07/S74ZA does not apply.

Example 3 – loss arising to an individual from a marketed tax avoidance scheme

- 20 Individual Y carries on a building trade. He also has a large, mixed portfolio of investments which give rise to income of £100,000 per year. Y enters into a scheme that is being marketed by a tax adviser which is designed to generate losses through contributions to an employee benefit trust and which is said to circumvent the anti-avoidance legislation relating to employee benefit

contributions. Y claims the loss, of £100,000, for set-off against his investment income.

- 21 The loss arises in consequence of relevant tax avoidance arrangements. To decide whether a main purpose of those arrangements is to obtain a reduction in tax liability by way of sideways loss relief it is necessary to look at all the circumstances in which the arrangements were entered into, including the participant's overall economic objective. In this case the main purpose of Individual Y entering into the arrangements was to obtain a reduction in tax liability by means of sideways loss relief. ITA/S74ZA therefore applies and no sideways loss relief is given for the loss.

Example 4 – loss arising to a partner from his profession

- 22 Individual Z carries on a profession in partnership. He also has significant income from investments. A client has filed a negligence claim against the partnership and is ultimately successful leading to the payment of significant compensation to the client which is not covered by the partnership's professional indemnity insurance. As a result of the compensation payment, the partnership makes a loss of £1 million. Z's share of this loss is £100,000. Z claims to set off the £100,000 against his investment income, leading to a reduction in his income tax liability.
- 23 The transaction giving rise to the loss arose in the ordinary course of the profession. The loss does not arise in consequence of or in connection with relevant tax avoidance activities as the main purpose, or one of the main purposes of the transaction was not the obtaining of a reduction in tax liability by means of sideways loss relief. ITA07/S74ZA does not therefore apply.