

NEW CLAUSE 18: PARTNERSHIPS EXPLOITING FILMS

Partnerships exploiting films

Mr Paul Boateng

To move the following Clause:-

'After section 118ZK of the Taxes Act 1988 (inserted by section 119) there is inserted-

"Partnerships exploiting films

118ZL Partnerships exploiting films

- (1) Where (apart from this section) an amount may be given to an individual under section 380 or 381 in respect of a loss ("the loss in question") sustained by him -
 - (a) in a trade consisting of or including the exploitation of films, and
 - (b) in an affected year of assessment,none of that amount may be given otherwise than against income consisting of profits arising from the trade; but this is subject to subsection (4).
- (2) An "affected year of assessment" means a year of assessment at any time during which the individual carried on the trade in partnership which is also-
 - (a) the year of assessment in which the trade is first carried on by him or any of the next three years of assessment,
 - (b) a year of assessment in which he did not devote a significant amount of time to the trade, and
 - (c) a year of assessment at any time during which there existed a relevant agreement guaranteeing him an amount of income.
- (3) For the purposes of subsection (2)(c)-

- (a) "a relevant agreement" means -
 - (i) an agreement that was made with a view to the individual's carrying on the trade or in the course of his carrying it on (including any agreement under which he is or may be required to contribute an amount to the trade), or
 - (ii) an agreement related to an agreement falling within subparagraph (i),
 - (b) an agreement "guarantees" the individual an amount of income if the agreement, or any part of it, is designed to secure the receipt by the individual of that amount (or at least that amount) of income, and
 - (c) it is immaterial when the amount of income would be received under the agreement.
- (4) If the loss in question derives to any extent from exempt expenditure, amounts that (apart from this section) may be given under section 380 or 381 in respect of the loss otherwise than against income consisting of profits arising from the trade may be so given to the extent that the total of the amounts so given does not exceed the exempt part of the loss.
- (5) The exempt part of the loss is so much of the loss in question as derives from exempt expenditure.
- (6) Expenditure is exempt expenditure for the purposes of this section if it is -
- (a) expenditure incurred before 26 March 2004 in a case where this paragraph applies, or
 - (b) expenditure that, for the purposes of the computation required by section 111(2), was deducted under section 41 or 42 of the Finance (No. 2) Act 1992, or
 - (c) incidental expenditure that, although deductible apart from section 41 or 42 of that Act, was incurred in connection with the production or acquisition of a film in relation to which expenditure was deducted under either of those sections.
- (7) Subsection (6)(a) applies where the individual carried on the trade before 26 March 2004.

118ZM Partnerships exploiting films: supplementary

- (1) In section 118ZL and this section any reference to a film is to be construed in accordance with paragraph 1 of Schedule 1 to the Films

Act 1985.

- (2) Section 118ZH (meaning of "a significant amount of time" etc) applies for the purposes of section 118ZL as it applies for the purposes of section 118ZE.
- (3) For the purposes of section 118ZL(3) agreements are related if they are entered into in pursuance of the same arrangement (regardless of the date on which either agreement is entered into).
- (4) The reference in section 118ZL(6) to the acquisition of a film is a reference to the acquisition of the master negative or any master tape or master disc of the film; and this subsection is to be construed in accordance with section 43(1) and (2)(b) of the Finance (No. 2) Act 1992.
- (5) In section 118ZL(6) "incidental expenditure" means expenditure on management, administration or obtaining finance.
- (6) The part of the loss in question that derives from exempt expenditure shall be determined on such basis as is just and reasonable.
- (7) The extent to which any expenditure falls within section 118ZL(6)(c) shall be determined on such basis as is just and reasonable.
- (8) In any case where sections 380 and 381 have effect as mentioned in section 118ZD(2) or 118ZI(3) (cases where sections 380 and 381 have effect as if loss carried forward from earlier year sustained in subsequent year), section 118ZL also has effect as mentioned in section 118ZD(2) or (as the case may be) section 118ZI(3)." '.

EXPLANATORY NOTES

SUMMARY

1. This new Clause implements legislation announced on, and effective from, 26th March 2004 to tackle tax avoidance schemes involving partnerships that carry on a trade of exploiting films but do not use the statutory film reliefs for British qualifying films. These schemes use Generally Accepted Accounting Practice to generate large initial losses, followed by a guaranteed income stream over several years, with the aim of producing tax deferrals for the individuals who invest in the schemes. The clause prevents an individual from obtaining relief for trading losses against his

other income or chargeable gains where the losses are sustained in a trade and where arrangements are made which seek to guarantee future income in that trade.

2. Losses derived from expenditure that is allowable under section 41 or 42 Finance (No. 2) Act 1992 are excluded from this provision. There is, therefore, no impact on relief for expenditure incurred on the production or acquisition of the master version of a British qualifying film which meets the conditions set out in Chapter I Part II of the Finance (No. 2) Act 1992. The new rules apply to individuals who do not spend a significant amount of time actively working in the trade and apply in the first four years that they carry it on. They will therefore not affect people who actively set up and carry on their own business.

DETAILS OF THE CLAUSE

3. The Clause inserts new sections 118ZL and 118ZM into the Income and Corporation Taxes Act 1988 (ICTA).
4. New Section 118ZL ICTA imposes a restriction on how trading losses sustained by individuals in a partnership exploiting films can be relieved. It defines the losses affected, and exempts losses deriving from certain types of expenditure on British qualifying films.
 - a. Subsection (1) is introductory. It sets out that an individual may not claim relief for trading losses against their other income or chargeable gains where the loss is incurred in a trade which includes the exploitation of films in a year of assessment to which this legislation applies.
 - b. Subsection (2) defines an "affected year of assessment" for the purposes of this section as any of the first four years of assessment in which the partner carries on the trade, but only in a year in which the partner does not devote a significant amount of time to the trade, and where there is a relevant agreement in existence in that year guaranteeing the partner an amount of income.
 - c. Subsection (3) defines "relevant agreement" for the purposes of subsection (2) and sets out the circumstances where such

an agreement is deemed to "guarantee" an amount of income. It makes it clear that the agreement does so if it is designed to ensure that an amount is received. The emphasis is therefore on what the agreement sets out to achieve, but does not imply a need for absolute certainty. In the schemes that this legislation tackles it is usually stated explicitly that an individual should receive certain amounts of income, but even if the agreement does not state this explicitly, it could still nonetheless be structured in a way that aims to achieve the same effect. The subsection also makes it clear that it is irrelevant as to when the guaranteed income would be received under the agreement.

- d. Subsection (4) qualifies subsection (1) to allow loss relief against other income or chargeable gains up to the amount of the exempt part of the loss as defined by subsections (5) and (6).
- e. Subsection (5) defines the exempt part of the loss as that which derives from exempt expenditure.
- f. Subsection (6) defines "exempt expenditure" for the purposes of subsection (5). It includes any expenditure which is deducted under the "film tax relief" rules found in section 41 (preliminary expenditure) or section 42 Finance (No 2) Act 1992 - as extended by section 48 Finance (No 2) Act 1997 (production or acquisition expenditure). These sections only apply to films which qualify as British (or, in the case of preliminary expenditure, would so qualify if completed) under Schedule 1 of the Films Act 1985. Exempt expenditure also encompasses incidental costs (defined by section 118ZM(5)) connected to the relevant preliminary, production or acquisition expenditure, such as management, administration or financing costs, which are not in themselves deductible under sections 41 and 42 but are otherwise deductible under general tax rules. Exempt expenditure therefore does not include spending on other aspects of film exploitation, such as distribution or "print and advertising", or production of a film as trading stock. Any expenditure incurred before 26 March 2004 is also exempt, but subsection (7) makes it clear that this only applies to an individual who was already carrying on the trade as a partner before that date.

5. New Section 118ZM ICTA sets out necessary definitions for the purpose of new section 118ZL.
 - a. Subsection (1) imports the definition of a film from Schedule 1 to the Films Act 1985.
 - b. Subsection (2) defines “significant amount of time”.
 - c. Subsection (3) defines what is meant by related agreements in section 118ZL(3).
 - d. Subsection (4) defines what is meant by “the acquisition of a film” in section 118ZL(6).
 - e. Subsection (5) defines what is meant by “incidental expenditure” in section 118ZL(6).
 - f. Subsections (6) and (7) state that the part of the loss that derives from exempt expenditure in section 118ZL(5), and the extent to which any expenditure is to be treated as incidental expenditure in connection with the production or acquisition of a film in section 118ZL(6)(b) are to be determined on a just and reasonable basis.
 - g. Subsection (8) ensures that section 118ZL applies to a year where section 118ZD ICTA or section 118ZI ICTA apply to treat a loss actually sustained in an earlier year as if it were sustained in the later year in question.

BACKGROUND NOTE

6. Where individuals carry on a trade in partnership, they are each individually regarded as carrying on the trade. Profits made by the partnership are allocated between the partners in accordance with the partnership agreement and each partner is individually liable to income tax on his share of the profits.
7. Similarly, any loss allocated to a partner is regarded as a loss incurred in a trade carried on by the partner individually. That loss can be claimed and relieved against the individual’s other income under section 380 or section 381 ICTA 1988, or against their chargeable gains under section 72 Finance Act 1991; or carried

forward to set against future profits from the trade under section 385 ICTA 1988.

8. For the purposes of allocating profits and losses, each partner is regarded as carrying on a separate trade which is deemed to commence on the date when the partner joins the partnership, and which is deemed to end when the partner leaves the partnership.
9. The film tax legislation sets rules on how the expenditure on the production or acquisition of a qualifying film is to be deducted for tax purposes. These rules are at section 41 Finance (No 2) Act 1992 for preliminary expenditure, and at section 42 Finance (No 2) Act 1992 (extended by section 48 Finance (No 2) Act 1997) for expenditure on the production of a film or the acquisition of the master version of a completed film.
10. In order to be a qualifying film, the film must have been certified as such by the Secretary of State for Culture Media and Sport under Schedule 1 to the Films Act 1985.