



HMRC

Partnership taxation: proposals to clarify tax treatment

1 November 2016

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. The ICAS Tax Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.
2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

General comments

3. ICAS is grateful for the opportunity to give evidence to HMRC regarding the consultation paper on 'Partnership taxation: proposals to clarify tax treatment', issued by HMRC on 9 August 2016.
4. We are grateful to HMRC representatives for coming to Edinburgh to discuss the consultation paper, and also to discuss issues that are particular to Scottish partnerships and how these interact with UK taxation.
5. A partnership is a popular business vehicle in Scotland and particularly so for the following types of businesses:
 - The professions – law, accountancy, doctors, dentists
 - The agricultural sector
 - Family businesses, and
 - Private equity and the fund management sector.
6. Partnership is the preferred route for traditional and rural businesses. It provides flexibility in a low risk environment. Fund management is a very significant and critical element of the Scottish economy, as well as the London economy.
7. A Scottish Limited Partnership (SLP) is a useful, and legitimate, business vehicle and particularly so for the following types of businesses:
 - The agricultural sector, where an SLP is the vehicle through which land is often let, and
 - The funds management /financial sector.
8. We note that there have been concerns expressed recently regarding the use of some SLPs. The recent publicity about SLPs being sold as tax avoidance vehicles is not at all a UK tax issue. The issue is that a Scottish LP is usually taxed by foreign jurisdictions as an opaque entity, a corporate. It can thus be abused. However, SLPs are a commonly and properly used part of the international financial sector and that use is not contentious and, in fact, is critical to the operation of that sector and to the industry.
9. Using taxation to address the problem will have a significant negative impact on a major UK industry, and the likely result would be funds and jobs moving to other jurisdictions. The remedy is thus not tax but to properly implement money laundering rules through regulating who can form and register SLPs.
10. We note that some of the drivers behind the consultation relate to the desire in HMRC for greater certainty so that Making Tax digital (MTD) processes can operate smoothly. However, whilst the MTD programme may ultimately simplify tax compliance for many taxpayers, in the short term it brings with it further legislative change, increased administrative burdens and hence adds to the general underlying complexity. One of the

long term calls which is regularly made by ICAS is to simplify tax, and to reduce the quantity and frequency of legislative change.

Specific questions

Clarification of who is the partner chargeable to tax

Question 1: Do you consider that the proposed clarification would provide certainty of treatment, including in cases where the partners registered at Companies House are different?

Question 2: Do you consider that the proposal would have any unintended impacts?

11. We have no comments in relation to these questions.

Business structures that include partnerships as partners

Question 3: Are there any tax or practical issues that need to be considered in relation to this proposal?

12. We question the merits of allocating income “upwards” to the first partnership and it is difficult to see how this would work in practice without creating additional administrative burdens.
13. There would be difficulties where the partnerships had different accounting periods and also where there are different nominated partners for the different partnerships.

Investment income - tax administration

Question 4: How do you think the tax administration of partnerships with investment income could be improved?

14. We understand that the investment industry uses partnerships in quite complex ways and that HMRC is considering how the relevant administration processes could be streamlined. In particular, this relates to investment partnerships and processes around international obligations about disclosure/sharing information but we caution that any new administrative processes should not be unduly onerous.
15. We received feedback from some members who indicated that there are problems for fund managers with registrations, UTRs, and partnership returns when the partnership is international and investors are not liable to UK tax and that, overall, the whole HMRC reporting system is rather cumbersome.
16. We note that with more automation and MTD HMRC would find it beneficial to have statutory underpinning to the process.

Trading and property income - tax administration

Question 5: What options could be considered to protect the Exchequer where a partnership does not provide details of some partners entitled to trading or property business profits?

Question 6: what practical issues would arise from the idea raised (in para 5.4) of payment on account, or from any other options to protect the Exchequer in respect of trading or property business profits, where information provided about partners is incomplete?

17. Changes to the administration for large partnerships would be welcome. The main issue is the design of the partnership return, which does not allow for straightforward reporting of multiple partners. However, proposals to combine this with MTD will need careful thought to prevent reporting from becoming more cumbersome.

18. Some of our members indicate that a requirement for “payments on account” for non-identified partners may be helpful for protecting the public purse, although it could lead to significant cash flow issues for many partnerships.

Allocation and calculation of partnership profit

Question 7: Do you consider that the proposed clarifications would provide certainty of treatment?

19. Many of our members have read the proposal outlined in paragraphs 6.3 and 6.4 of the consultation document as meaning that partnership profit allocation must be set out in the partnership agreement and that HMRC must be notified of any change. Following our meeting with HMRC, however, we understand that it is not the intention to disturb the existing position on profit allocation. We would very strongly oppose any attempt to interfere with the existing right of partners to allocate profits as they so wish for the following reasons.
20. Our members have noted that the imposition of profit allocations could lead to HMRC needing to be given sight of all partnership agreements; and needing written agreements detailing changes each year.
21. It would also imply that allocation would have to be determined in advance. Many partnerships, particularly large professional partnerships, have an element of discretionary profit share which is decided at the end of a financial year based on performance and clearly cannot be set in advance. There are other potential issues, such as, how HMRC would collate information on the current partnership agreements. Many partnership agreements do not specify a profit share so there is the question of how they would be dealt with. There would also need to be a process by which accountants/agents were made aware of the notifications. And there is the question of what would happen where the nominated partner failed to make the notification - would the other partners be assessed on profits they had not received (nor were legally due)? There is no requirement for companies to report on the dividend policy or remuneration proposals they adopt – why should partnerships?
22. Further uncertainties would arise: does the proposal mean that a single accounting profit share proportion would be used to divide all profits/income/gains? Would it include capital gains? There can be many situations where a partnership profit is divided amongst partners on a complex basis, looking at the performance of individual sectors or divisions of the business, capital versus income returns, etc. New rules imposing profit allocations could lead to partners being taxed on types of income or capital growth that they have no economic interest in. This would have the largest impact on items taxed as capital gains, and the interaction with SP D12 would be complex.

Allocation of profits and dispute resolution

23. Following our meeting with HMRC we now understand that the proposals are not designed to impose allocations upon partnerships. We understand that HMRC simply wishes, where there is a dispute about profit share between a partner and the partnership, to be able to impose an assessment based on the best possible evidence. That would result in either following the allocation per the partnership return or an amendment to it based on that evidence. It would then be for the partners to sort out any dispute amongst themselves and, if that resulted in a change to the partnership return, then this would follow through to the individual returns with appropriate adjustments being made.
24. In summary, we understand that the proposals around profit allocation in chapter 6 are:
- Not aimed at creating or imposing any further reporting requirements
 - For use in the event of a profit allocation dispute on quantum (and not, for example, regarding disputes about the treatment of an expense or potential addback)
 - Seeking good housekeeping, especially in larger partnerships, and
 - Not about giving further power to a nominated partner.

25. If this is simply a proposal to assist HMRC in collecting the tax due when there is a partner dispute about the allocation of a quantum of profit, and does not seek to override a partnership allocation that is agreed, then we have some sympathy regarding the problem. However, there is the difficulty that if the nominated partner responsible for completing a partnership tax return may do so without the agreement of the partners, there must be scope for a partner to disagree an allocation of profit if done without their consent. We question whether the problems around disputes over profit allocation can be resolved by a proposal that simply overrides the dispute for tax purposes.

Allocations of tax adjusted profits to partners

26. We understand that HMRC is seeking to put in place a statutory underpinning to prevent non-commercial tax avoidance arrangements whereby, for example, a partnership may allocate specific expenses to a specific partner such as a disallowable entertaining expense to a non-taxpayer. Our members are supportive of HMRC's desire to prevent non-commercial allocations but in some instances there might be a number of trades within a partnership, or there might actually be a number of different partnerships. It would not be helpful if any new measure impinged on the current tax treatment of farms and estates.

Question 8: Do you consider that the proposals would have any unintended impacts or create practical difficulties?

27. We have no comments in relation to this question.

Question 9: Are there any other areas in the current rules for allocating or calculating profits that should be changed to increase certainty in the tax treatment of partnerships?

28. We have no comments in relation to this question.