Partnership taxation: proposals to clarify taxation treatment
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary and recommendations

1.1 We welcome the opportunity to respond to these proposals. Our response concentrates only on the potential effects on low income taxpayers or other vulnerable groups whom we seek to represent. This means our responses are mainly in connection with general partnerships, although they may apply equally to other types of partnership. We provide no comments on partnerships where there are partners resident outside the UK other than brief comments at 3.3 below.

1.2 While we understand and support the proposition that all partners should pay their share of tax in the UK we are concerned that some of these proposals will be impractical for some partnerships where the nominated partner may not know the identities of all the people who are 'stakeholders' in the partnership.

1.3 Using the allocation of accounting profits as a base for allocating profits for tax purposes appears to require a change to current tax legislation, as we discuss further at 4.14.1 below.

1.4 We cannot support the proposal that individual partners **must** report on their individual tax return their share of the partnership profit as reported by the nominated partner of the partnership tax return. There may be circumstances where there is a disagreement. We explore this further at 4.13.1 below.

1.5 Given our comments above, we are unconvinced that implementing all of these proposals would make it easier for the people we represent to report their share of partnership profits.

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2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue &Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 General comments

3.1 We recognise that a partnership is a very flexible structure for a business to adopt. It has considerably fewer legislative requirements than a company, say, but allows pooling of resources from more than one person and an associated sharing of profits and losses.

3.2 In addition we recognise that it is desirable that HMRC can identify partners in partnerships and so be able to collect tax effectively, but our constituents would not generally be involved in such complex structures where their identity would not be apparent.

3.3 We are aware that some of our constituents, resident in the UK, are members of partnerships some of whose members may be resident overseas and where the management and control of the partnership may well be overseas. In many cases these are partnerships among family members. A trade is operated in the UK, and overseas, but a share of the UK profit is allocated and remitted to the partners resident outside the UK. In this scenario we think the UK resident members of the partnership would be able to name the non-UK resident partners. In some cases these partners resident outside the UK will be entitled to a UK personal allowance that will extinguish any UK liability in any case.

3.4 In practice, some partnerships have frequent changes of partner and even more frequent changes in profit sharing ratios. Where a partnership has members with unequal rights, an individual partner may not even be aware that their profit share has been altered or may potentially have been altered. For example, partner A may have a 'fixed profit share', although they have full voting rights. A new partner B is introduced who is also given a fixed profit share but full voting rights. At the end of the year, there is insufficient profit to satisfy all of the fixed profit shares and so those shares are necessarily scaled back. In this scenario neither partner A nor partner B may have realised that their profit share might be altered. This can lead to disagreements over partnership shares that may take some time to resolve.

4 Responses to specific questions and proposals

4.1 **Proposal 1**: The government proposes that for tax purposes a person will be treated as a partner in a partnership if they are notified to HMRC as partners in the partnership return.

4.2 **Question 1:** Do you consider that the proposal is sufficient to provide certainty of treatment, including in cases where the partners registered at Companies House are different?

4.2.1 While we think this proposal is sensible, there must be a right of appeal against such a measure. We are concerned that the nominated partner may not always be aware of the identities of the other partners, for example when one of the partners is acting as a nominee; or the nominated partner may be obliged to report the underlying partners in another partnership about which they have little knowledge.

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

4.3.1 We have no comment.

4.4 **Proposal 2**: The government is looking to legislate to provide that that those responsible for paying the tax on a share of partnership profit are treated as partners in the first partnership for the purposes of income tax, capital gains tax and corporation tax. Details of the partners, including those treated as partners under these proposals, and their share of the partnership profit or loss will be reported by the nominated partner of the first partnership on the partnership return and statement for the first partnership.

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

4.5.1 As noted above, the nominated partner of a partnership may not know the identity of all of the partners. We make no further comment as this is unlikely to be relevant for our constituents.

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

4.6.1 It can be difficult for taxpayers to understand that investment income (as well as any capital gain) has to be reported on a tax year basis rather than for the period of accounts. While it may have seemed appropriate to include a *de minimis* amount that could be treated as trading income, this is unlikely to be fair for our constituents, some of whom may benefit from the starting rate for savings as well as the savings and dividend allowances. It is possible that if the proposals included in the Making Tax Digital consultation documents[1] concerning changes to basis periods may solve this problem for our constituents.

4.7 **Proposal 4**: The government wishes to explore options for protecting the Exchequer where the details of partners entitled to trading or property business partnership profits are not provided by the partnership. One such option could include a payment being made on account to HMRC on behalf of any partners who are not identified.

4.8 **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?

4.8.1 We have no comment as we do not believe this would be relevant for our constituents.

4.9 **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?

4.9.1 In some such cases, the partner for whom the tax is being paid may, in fact, have no capital in the business so that the tax would in reality be borne by the other partners. In addition, their partnership agreement might preclude such payments being made. If this route was to be pursued we would be interested to hear how the partnership might seek to recover the tax paid if none were due, possibly due to other activities, or the status, of the overseas partner. It seems to us that HMRC are taking the easier option of demanding tax from a partnership that is trying to be compliant instead of pursuing the balance of the information about the absent partners.

4.10 **Proposal 5**: In order to provide certainty, the government considers that legislation should be introduced to confirm that the profit sharing arrangements as set out in the partnership or LLP agreement are the determining factor in identifying the partners' profit shares.

4.11 **Proposal 6**: Legislation would be introduced to provide that the basis of allocation of tax adjusted profit should be the same as the allocation of the accounting profit or loss between the partners. This legislation would apply to both partnerships and LLPs. Partners or members would only share in profits or losses for the period in which they were partners or members.

4.12 **Proposal 7**: Legislation would be introduced to provide that the profits of company partners liable to income tax will be calculated as if a non- UK resident company were carrying on the business.

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

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[1] Business Income Tax: Simplifying tax for unincorporated businesses

4.13.1 No. As noted in the general comments above, profit sharing ratios can change without a partner being aware of that fact. Further, an individual partner may dispute their share of profit where it was dependent upon a particular event, for example retaining a particular client of the partnership. It would therefore be wrong to expect a partner to file their tax return while remaining convinced that the partnership profit figure that they were including was incorrect. Indeed this is contrary to the declaration signed by the individual taxpayer 'I declare that the information I have given on this tax return and any supplementary pages is correct and complete to the best of my knowledge and belief. I understand that I may have to pay financial penalties and face prosecution if I give false information.' If this proposal is in response to HMRC losing the First Tier Tribunal case of *King & Others v HMRC*,[1] we believe considerably more thought needs to be given to the implications.

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

4.14.1 Proposal 6 would appear to change the current practice of allocating profits among partners. This can be illustrated by the case when a partnership has made an overall profit, but that profit is insufficient to satisfy all of the 'fixed share' entitlements. In that situation some profit sharing partners might be allocated a loss for accounting purposes, while other partners might have profits. Where the partnership as a whole has made a profit current legislation[2] requires reallocation of any losses that would otherwise be allocated to a partner so that no partner is allocated a loss for tax purposes.

4.15 **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?

4.15.1 The whole area of capital gains in partnerships is fraught with difficulty as there is little actual legislation on the topic. Guidance on GOV.UK[3] is very poor.

LITRG
20 October 2016

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[1] *King & Others v HMRC* [2016] UKFTT 409 (TC)

[2] Ss 849-850E ITTOIA 2005

[3] https://www.gov.uk/capital-gains-tax-businesses/work-out-your-gain