Minutes of WG2 Meeting

10am – 12.30pm Friday 24 January 2014

HMRC, Room G26, 1 Horse Guards Road, London, SW1A 2HQ

Attendees

David Boneham (CIOT / Deloitte)
Graham Williams (PwC)
Andrew Seagren (KPMG)
Catherine Linsey (ECI Partners)
Paul Baldwin (FTI Consulting)
Alex Jupp (Skadden)
Jonathan Richards (Ernst & Young)
Andrew Hastie (LBG)
Graham Iversen (Slaughter and May & BVCA)
May Lam (Prudential / ABI Rep)
Stuart Sinclair (Bingham McCutchen)
Lydia Challen (Law Society / Allen & Overy)
Nikol Davies (Taylor Wessing)

(collectively the "**group**")

Tony Sadler (HMRC) - **Chairman**
Mark Lafone (HMRC)
Richard Daniel (HMRC)
Andrew Scott (HMRC)
Liz Ward-Penny (HMRC)

(collectively "**HMRC**")

Apologies

Ann Brennan (GE / BBA Rep)
Adam Frais (BDO)
Vincent Maguire (Clifford Chance)
Lara Okukenu (Deloitte)

Introductions and background

HMRC opened the meeting by summarising that the main focus was to discuss partnership issues and in particular the draft partnership legislation published for consultation on 17 January 2014. The wording of the consultation draft had a number of changes from the draft partnership legislation circulated to the group by HMRC on 19 December 2013, reflecting the group's views and comments.

Shortly after Budget 2014, HMRC will issue a Technical Note setting out the scope of the project as whole for the next year, grouping proposals into 3 categories:

a. Flagship changes to be made in Finance Bill 2015, subject to Ministerial approval, as contributing strongly to the objectives of the regime review, for example following the income statements;

b. Possible improvements to the legislation without making substantial policy changes, if time and resource permit, for example aligning tax and accounting in amortised cost basis;

c. Areas not intended to be pursued, for example a new approach to group continuity as the consultation responses indicated a strong preference for minimal change in this area.

HMRC welcomed comments from members on what proposals might be included in each of these categories. The indicators to consider for each category would be circulated to working group members after the meeting.

1. General overview

Before proceeding, HMRC reiterated that the priority was to focus on the consolidation of the rules on partnerships, and the core principle, in a new Chapter 9 in Part 5 CTA 2009 in the draft legislation for partnerships.

The next task would be to align the rules for derivative contracts in Part 7 with the new Chapter 9, Part 5 rules. This should be a simpler exercise as there was no equivalent to s467 and s474 CTA 2009. The aim was to align these rules in Finance Bill 2014, if possible, but otherwise it might need to be deferred until Finance Bill 2015.

The next objective would be to consider issues involving transparent entities and changes in partners' profit share ratios etc.

2. Section 302(2A) CTA 2009

HMRC: This subsection was to be inserted into the primary definition of a loan relationship (at section 302 CTA 2009).

To the extent that a company operates through a partnership which in turn is party to a money debt arising from a transaction of the lending of money, then section 302(2A) CTA 2009 points you towards the operative section 380A CTA 2009.

Several members of the group commented that the sign posting was helpful in that it got the deeming aspect of the corporate partner having a loan relationship up front. Its inclusion did not hurt.

The group was comfortable with retaining this subsection.

3. Section 380A – General

HMRC: As many of the group's previous comments had been incorporated into the published consultation draft as possible. There were 2 areas that HMRC would like to tease out in discussions:

a. Was the current draft legislation too detailed in some areas? Could the same principles be expressed more simply?

An example of where it might be possible to simplify the current draft was whether all of the current wording of s380A(3) to (5) was needed.

b. Were there any areas where the draft legislation did not go far enough? Did certain principles need to be more detailed to clarify the position?

An example of where it might be necessary to provide more detailed provisions in the draft was to clarify how to deal with a transfer of a loan relationship between a partner and a partnership and each party "becoming" or "ceasing to be party to" that loan relationship.

4. Section 380A(1)

HMRC: Subsection (1) states when section 380A should apply.

As agreed at the last meeting, HMRC had discussed the use of the words "trade or other business" with Parliamentary Counsel who had confirmed that this drafting was appropriate. It had therefore been retained in the consultation draft.

5. Section 380A(2)

HMRC: Subsection (2) then states the base case deeming provision.

'Apportioned'

HMRC said that at the previous working group meeting there had been some discussion whether "apportioned" and "apportionment" were the correct terms to use in this context. As agreed, HMRC had discussed the matter further with Parliamentary Counsel.

HMRC remained of the view that these terms were currently used elsewhere in the legislation and did not appear to cause any difficulties but invited further comments from the group to take into account their use as a result of other changes to the wording of the consultation draft from the previous version.

Several group members commented that they did not think anything turned on the use of these words. It was agreed that it was unnecessary to substitute different words.

Interaction with Part 6 - use of ' Money debt'

HMRC: 'Money debt' also occurred in S380A(4). This term was an example of where the legislation might be too detailed.

Part 6 applies to a range of cases that are treated as loan relationships, including those where there is a money debt that does not arise from lending money and others where there was no debt, but the instrument or arrangement is deemed to be a loan relationship (for example, disguised interest, alternative finance). The policy intention was for the rules in Part 6 to be engaged and work in the same way as set out in Part 5. There was a concern within HMRC that the use of 'money debt' rather than the 'loan relationship' might cause the rules to misfire. Was the use of the term necessary or did it get in the way?

A member of the group commented that S380A(2)(c) did not use "money debt". As anything done by the firm is treated as done by the corporate partner, the draft legislation could be construed as deeming the corporate partner to have a loan relationship, and so bringing in all aspects of the regime for the purposes of Part 5. In any case s294 CTA 2009 "matters treated as loan relationships" should achieve the policy intention.

Another member of the group queried the use of 'money debt' rather than 'loan relationship'.

HMRC confirmed that the definition of a loan relationship required that it is a company that is a party to the loan relationship.

There was some discussion as to the legal and conceptual differences between the legal personality of a partnership and the tax rules. A member of the group commented that a deeming provision is needed so that the corporate partner will be treated as a party to the firm's loan relationship (contrasting a chose or interest in the firm's assets as a matter of law).

HMRC commented that the content of current s380A was reasonably robust. S380A(2)(a) made it explicit that the corporate partners are parties to the firm's loan relationship, but asked whether the policy principles could be put across more simply, possibly by a small change to the general structure of s380A(3) to (5). The December draft legislation had a more minimalist approach which the consultation draft had expanded.

8. Section 380A(4)

HMRC: This subsection is intended to instruct the corporate partner to determine debits and credits by reference to the accounts of the firm.

A member of the group commented that the "accounts" of the firm relate to the partnership and so would cover the whole profit or loss of the loan relationship which would require apportionment among the partners. The firm's accounts would not cover what the corporate partner would be deemed to have vis a vis the other partners - ie. matters such as the change of profit-share between partners.

HMRC confirmed that there were 2 different levels to be taken into account:

- what the firm does and
- the partner to partner transactions / dealings

HMRC suggested that it might be possible to revise the consultation draft wording along the lines of saying that s380A(2)(c)(ii) sets out what has to be done to arrive at the credits and debits calculation and s380A(4) would say that the starting point for doing the apportionment would be the firm's accounts instead of the corporate partner's accounts.

9. Section 380A(5)

Firms without generally accepted accounting practice (GAAP)compliant accounts

HMRC: This subsection is intended to replicate the policy intention at current s309 CTA 2009 for partnerships. In view of the scope of s380A(2)(c), referring to what the firm does, is s380A(5) needed? Could the same result be achieved by altering the current wording of s380A(2)(c) to cover what a firm has omitted to do (for example drawing up GAAP compliant accounts) or simplifying s380A(3) and (4) instead?

HMRC confirmed that the policy intention was for the corporate partner to include in its corporation tax self-assessment ("CTSA"), its share of the firm's loan relationships by reference to the partnership's accounts. If the firm did not have GAAP compliant accounts, then the corporate partner would need to do a GAAP compliant computation using the firm's accounts in order to arrive at its own adjusted profits and losses for the period.

A group member commented that it added an extra layer of complexity for a corporate partner and asked what accountancy standards should be used by a foreign partnership.

HMRC acknowledged the above point but said it was an existing issue as there was no change to the policy intention and referred to Tax Bulletin 62/2002. This policy was also expressed in the existing rules in s1259 CTA 2009 for corporate partners who needed to file their own CTSA returns, covering their share of (non-loan relationship) profits and losses of the firm. HMRC further confirmed that foreign partnerships would be expected to use IFRS or UK GAAP, as applicable. The normal meaning of GAAP would apply, as it does now through s309 CTA 2009.

Several working group members commented that it would be helpful to retain the s380A(5) provision and that it should not be bolted onto S380A(2). Not all of the group members agreed that the principle expressed in s380A(5) was a natural consequence of s380A(2). For example, there was a difference between a partner's omission and a partnership's omission.

A group member commented that members of Private Equity Partnerships had no trade and so were not required to do an s1259 calculation, but they would be impacted by this provision as they did have shares in companies, debts and derivative contracts.

HMRC asked whether this point could be clarified through revisions to the existing guidance rather than retaining s380A(5). It was felt that it would be useful to make clear in guidance that the corporate partner would not be required to reconstruct full GAAP compliant accounts of the firm but only to compute the firm's accounts on a GAAP compliant basis as far is necessary to apply the statute. Again this is similar in cases where UK GAAP compliant accounts are not prepared currently - eg. foreign companies.

A number of working group members expressed a strong preference for retaining s380A(5). It made construing the legislation more accessible without having to go to guidance to understand what was meant and there would be less uncertainty over the intended outcome. The consultation draft legislation was clearer what was required to be done, and by whom, which had been discussed at some length at the previous meeting.

Acts or omissions

A group member said that the use of "acts or omissions" at s380A(2)(c) seemed to be a blunt instrument and could lead to some absurdities. For example, the firm not preparing GAAP compliant accounts could lead to the interpretation that the corporate partner had not prepared its own GAAP compliant accounts.

A member of HMRC explained that this conclusion should not arise in practice as any such deeming would be overridden by the underlying factual position that the company partner had drawn up its own GAAP compliant accounts.

A member of the group commented that if HMRC wanted the position to be as clear as possible, then as a drafting point it might be better to avoid using "omissions".

HMRC said that a deeming provision was only taken as far as it needed to be in order to achieve its end. S380A(2)(b) was overridden by the existing provision of " for the purposes of Part 5" ie this subsection was not saying that all of a firm's assets and liabilities would be brought in (where they did not relate to loan relationships). HMRC also confirmed that s380A(2) of the consultation draft used identical wording to the existing "connection" and "control" provisions.

10. Section 380A(7) – see also discussion on profit-share arrangements below

HMRC: This subsection defines the term 'appropriate share' by a formula meaning that the share of any profit of loss apportioned to the corporate partner is in accordance with the firm's profit-sharing arrangements for the period.

HMRC asked the group to comment whether or not they found the use of a formula helpful, for example where 'PL' is zero.

It was generally felt by the group that it was preferable for the formula to be removed so that the readers of the legislation could focus on the wording instead, which should echo the language used in the existing legislation.

11. Section 380A(8)

HMRC: This subsection disapplies the provisions of s380A applying to corporate general partners in limited partnerships that are collective investment schemes for the purposes of establishing control or connection.

A member of the group commented that this subsection seemed to be achieving the same effect as the current legislation for the purposes of control and connection.

12. Section 380B

HMRC: This section deals with cases where there is lending between a partnership and one of its corporate partners.

Transactions between partners and partnership – related transactions

HMRC: This section might be an example of where the legislation did not go far enough. Instead, it could be extended to cover other transactions between the firm and the corporate partner. For example, for transfers between a partner and the partnership, do the group continuity rules apply or does the consultation draft legislation need to be revised so as to be able to bring the transaction into these rules?

HMRC confirmed that for the purposes of the discussion, this issue related to transfers of a loan relationship and not of shares in the partnership. S380A(6) of the consultation draft referred to a company being treated as a counterparty to itself and a possible change might be to bring this subsection within s380B instead. However, this represented a fairly static state whereas the group continuity rules operated by a company "becoming a party to" or "ceasing to be a party to" a loan relationship. This raised a number of issues including for example, whether or not a company could be within the same group as itself and when a loan relationship was transferred between parties, whether or not it was the same loan relationship that the party was acquiring or disposing of their share in.

A member of the group pointed out that where the firm assigned the debt, the consultation draft legislation would deem this act to have been done by the corporate partners under s380A(2)(c)(i).

The group agreed that the consultation draft legislation did not currently cover the assigning of a loan relationship and so the current draft needed to be revised to set out what the tax position should be, in particular by linking the related transaction into the existing group continuity rules where appropriate.

A member of HMRC said that the position was simpler for derivative contracts in that they could not be assigned but had to be novated, so that legally these became a separate contract.

Profit share arrangements

HMRC asked if the consultation draft legislation should also reflect other transactions between corporate partners such as changes of profit-sharing ratios.

A group member commented that such changes might not be a related transaction of the firm. If there was any profit or loss arising from the change in profit-sharing ratios, it would not be reflected in the

firm's accounts. The consultation draft legislation did not seem to cover this scenario as a related transaction and so if this was a situation that needed to be covered then the legislation would need to be revised.

Another group member commented that there was difficulty in ascribing a particular value to the transaction. The transaction would be dealt with by reference to the firm's accounts, but the legislation would need to show how the appropriate value reflected by that change in the partner either acquiring or disposing of part of the assets and liabilities of the partnership was to be computed. It was felt that the wording of s380A(2)(a) of "appropriate share" might be too general for these purposes.

There was some discussion that s380A(7) referred to the profit or loss of the firm for the ***period*** and to the firm's ***period*** of account. Several group members queried what period of time needed to be considered when there was a change in partnership shares ie on a snap-shot basis or over a longer time for example accounting period.

HMRC suggested one possibility of removing the reference to a firm's "period of account" as this would allow greater flexibility. Several group members agreed that while it allowed greater flexibility, it would also create some uncertainty as to what should be done and how the appropriate share was to be worked out.

Another member of the group asked if what was being considered was a share of the firm's debt being fixed by reference to the corporate partner's profit-share, and questioned whether this gave an appropriate result. HMRC commented that the firm's debt would be shown on the firm's balance sheet but not the shares of that debt allocated between the partners The purpose of the whole exercise was principally for the corporate partner to be able to calculate any profit or loss arising on the firm's debt for the purposes of bringing it within the loan relationship regime. It therefore seemed right that the partner's share of the profits or losses should drive the allocation between partners.

A group member said that in contrast to the consultation draft legislation, the current loan relationship rules do not operate by slicing up the whole debt, but looked at the whole loan relationship.

HMRC noted that the connection rules at s467 CTA 2009 did slice up the loan relationship. HMRC also commented that the consultation draft legislation operated slightly differently in that what was being identified was a partner's share in that loan relationship at a particular point in time.

HMRC: Summarised the discussion that there was general agreement that the wording in the current legislation at s381 CTA 2009 worked effectively in the majority of cases, but it seemed that the definition of 'appropriate share' in s380A(7) including references to "any period of account of the firm" and to "any profit or loss of the firm for the period" appeared to potentially cause difficulties but simply deleting the reference to "a period" could equally make the provision too vague. There was a distinction between:

- changes in partnership shares from period of account to period of account (which should not present difficulties in being able to tax profits or relieve losses of that period) and
- partner to partner transactions which HMRC wanted included in the loan relationship regime as a related transaction.

HMRC: Summarised three areas that needed clarification in the next version of the draft legislation:

- to be able to define what should be included as a related transaction;

- is the reference in s380A(7) to a period of account an unnecessary limitation? and
- what profit-sharing arrangements (which might be wider than the Partnership agreement) are being used?

13. Next steps and timing

HMRC thanked members of the group for their valuable contributions and would continue to respond to the feedback received, both at the meeting and in separate comments, in their instructions to and discussions with Parliamentary Counsel.

As the timetable was very tight in order to meet the deadlines in the run up to Finance Bill 2014, HMRC asked if it might be possible to form a smaller sub-group of the working group to discuss any particular partnership issues that arose which would be able to meet at short notice and on an ad-hoc basis. The results of those discussions would be fed back to the wider working group in their meetings. The group agreed that this would be sensible and 6 members volunteered their availability to be called on by HMRC, should the need arise.