



## Partnerships review: partnerships with mixed membership

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### Who is likely to be affected?

This change will affect partnerships, including Limited Liability Partnerships, where the partners or members include both individuals and non-individuals (mixed membership partnerships). Most commonly the non-individuals will be company members of the partnership.

### General description of the measure

The first element of this change will affect mixed membership partnerships where partnership profits are allocated to a non-individual partner in circumstances where an individual member may benefit from those profits. The second element will affect cases where partnership losses are allocated to an individual partner, instead of a non-individual partner, to enable the individual to access certain loss reliefs.

### Policy objective

This change makes the tax system fairer by preventing tax-motivated allocations of business profits and losses in mixed membership partnerships, including Limited Liability Partnerships.

### Background to the measure

This change is part of a wider review of certain parts of the partnership rules announced in Budget 2013. A consultation document, *Partnerships: A review of two aspects of the tax rules* was published on the gov.uk website on 20 May 2013 and the consultation closed on 9 August 2013.

## Detailed proposal

### Operative date

The changes will take effect from 6 April 2014 with the exception of anti-avoidance rules concerning tax-motivated profit allocations. These rules come into force on 5 December 2013 in order to protect against risks to tax revenue.

### Current law

The rules governing the allocation of a firm's profits and losses between partners for income tax and corporation tax purposes are in Part 9 of the Income Tax (Trading and Other income) Act 2005 (ITTOIA 2005) and Part 17 of the Corporation Tax Act 2009 (CTA 2009).

The general rule in section 849 of ITTOIA 2005 and section 1262 of CTA 2009 is that for any period of account a partner's share of a profit or loss of a firm is determined in accordance with the firm's profit-sharing arrangements during that period. This rule is subject to sections 850A and 850B of ITTOIA 2005, for income tax, and sections 1263 and 1264 of CTA 2009, for corporation tax, which revise the allocation where the firm is profit-making for the period but some partners have losses or the firm is loss-making but some of the partners have profits.

## Proposed revisions

Legislation will be introduced in Finance Bill 2014 in relation to mixed membership partnerships to reallocate excess profits allocated to a non-individual partner to an individual partner where the following conditions are met:

- a non-individual partner has a share of the firm's profit;
- the non-individual's share is excessive;
- an individual partner has the power to enjoy the non-individual's share or there are deferred profit arrangements in place; and
- it is reasonable to suppose that the whole or part of the non-individual's share is attributable to that power or arrangements.

The legislation will include provision so that excess profits can be reallocated to an individual who is not a partner if it is reasonable to suppose that the individual would have been a partner but for the new rules and the whole or part of the non-individual's share is attributable to the individual's power to enjoy the non-individual's share or to deferred profit arrangements.

The legislation will also include consequential provisions to prevent double taxation.

Legislation will also be introduced in Finance Bill 2014 to deny certain income tax loss reliefs and capital gains relief for a loss allocated to an individual partner where the individual is party to arrangements, the main purpose of which, or one of the main purposes of which, is to secure that some or all of the loss is allocated, or otherwise arises, to the individual, instead of a non-individual, with a view to the individual obtaining relief.

## Summary of impacts for the review

The following table is a summary of impacts for the partnerships review announced in Budget 2013 of which the change described above is a part.

<b>Exchequer impact (£m)</b>		2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	Budget	nil	+125	+365	+300	+285	+270
	Extra	nil	nil	+680	+430	+410	+400
	Total	nil	+125	+1045	+730	+695	+670
	<p>The first row presents the figures published at Budget 2013 that were set out in Table 2.1 of the Budget Report and certified by the Office for Budget Responsibility (OBR) at that time. More details about the original figures can be found in the policy document published alongside the Budget.</p> <p>The second row presents the extra costing attributable to the alternative investment fund management (AIFM) sector and has been estimated using information gathered during the consultation carried out over the summer. These figures are set out in Table 2.1 of the Autumn Statement 2013 and have been certified by the OBR. The policy document published alongside the Autumn Statement provides further details.</p>						
<b>Economic impact</b>	<p>This measure will result in a more level playing field through reducing distortions to competition and to the allocation of resources among sectors driven by tax planning. It may also result in an increase in labour costs and a decrease in post-tax profits levied on selected partnerships in certain industries. Overall, the impact on the economy should be small.</p>						

<b>Impact on individuals and households</b>	Those individuals who are affected members of partnerships will now be required to pay the correct amount of tax and National Insurance contributions (NICs) at broadly the right time. It is possible that there is a modest reduction in administrative burden for some individuals who will pay through PAYE rather than having to fill in a self assessment return. Overall the impact is expected on individuals and households to be negligible.
<b>Equalities impact</b>	No impact is expected on any protected equality groups.
<b>Impact on businesses including civil society organisations</b>	<p>This measure will have a negligible impact on businesses and civil society organisations.</p> <p>The existing evidence suggests that the majority of partnerships will not be affected by the consultation proposals. Those partnerships affected are likely to be limited in number and they are primarily large professional or AIFM partnerships.</p> <p>There would be some one off costs as professions and taxpayers need to understand the new rules and communicate them to their partnership members.</p> <p>For those AIFM partnerships which choose to use a new paper-based process to account for tax and NICs, administrative costs are expected to be negligible as they are already required to record and process the information in order to comply with the regulatory and tax requirements.</p>
<b>Operational impact (£m) (HMRC or other)</b>	<p>The AIFM process requires changes to HM Revenue &amp; Customs' (HMRC) systems and they are estimated to cost up to £1.6 million. There will also be some extra administrative costs to be borne by HMRC, currently estimated at £260,000 per annum.</p> <p>There would also be some additional operational costs associated with the monitoring and checking records of notional and actual partners of partnerships but these are expected to be minimal.</p> <p>For the relatively few public sector organisations using the partnership model, there would be administrative costs to understand the new rules.</p>
<b>Other impacts</b>	Other impacts have been considered and none have been identified.

## Monitoring and evaluation

The partnerships review measure will be monitored and assessed alongside other measures in the Government packages for fairer taxation and avoidance.

## Further advice

If you have any questions about this change, please contact James Ewington on 03000 553788 (email: [partnership.review@hmrc.gsi.gov.uk](mailto:partnership.review@hmrc.gsi.gov.uk)).

## Declaration

David Gauke MP, the Exchequer Secretary to the Treasury, has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.

## **1 Partnerships**

Schedule 1 makes provision in relation to partnerships.

## SCHEDULES

### SCHEDULE 1

Section 1

#### PARTNERSHIPS

#### PART 1

#### PARTNERSHIPS WITH MIXED MEMBERSHIP

#### *Main provision*

- 1 (1) Part 9 of ITTOIA 2005 (partnerships) is amended as follows.
  - (2) In section 850 (allocation of firm's profits and losses between partners) in subsection (1) for "and 850B" substitute "to 850D".
  - (3) After section 850B insert –  
**"850C Excess profit allocation to non-individual partners**
    - (1) Subsections (4) and (5) apply if –
      - (a) for a period of account ("the relevant period of account") –
        - (i) the calculation under section 849 in relation to an individual partner ("A") (see subsection (6)) produces a profit for the firm, and
        - (ii) A's share of that profit determined under section 850 or 850A ("A's profit share") is a profit or is neither a profit nor a loss,
      - (b) a non-individual partner ("B") (see subsection (6)) has a share of the profit for the firm mentioned in paragraph (a)(i) ("B's profit share") which is a profit (see subsection (7)), and
      - (c) condition X or Y is met.
    - (2) Condition X is that it is reasonable to suppose that –
      - (a) amounts representing A's deferred profit (see subsection (8)) are included in B's profit share, and
      - (b) in consequence, both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would otherwise have been.
    - (3) Condition Y is that –
      - (a) B's profit share exceeds the appropriate notional profit (see subsections (10) to (17)),
      - (b) A has the power to enjoy B's profit share ("A's power to enjoy") (see subsections (18) to (20)), and
      - (c) it is reasonable to suppose that –

- (i) the whole or any part of B’s profit share is attributable to A’s power to enjoy, and
  - (ii) both A’s profit share and the relevant tax amount (see subsection (9)) are lower than they would have been in the absence of A’s power to enjoy.
- (4) A’s profit share is increased by so much of the amount of B’s profit share as, it is reasonable to suppose, is attributable to –
  - (a) A’s deferred profit, or
  - (b) A’s power to enjoy,as determined on a just and reasonable basis.

But any increase by virtue of paragraph (b) is not to exceed the amount of the excess mentioned in subsection (3)(a) after deducting from that amount any increase by virtue of paragraph (a).
- (5) If B is chargeable to income tax, in applying sections 850 to 850B in relation to B for the relevant period of account, such adjustments are to be made as are just and reasonable to take account of the increase in A’s profit share under subsection (4).

(This subsection does not apply for the purposes of subsection (7) or section 850D(7).)
- (6) A partner in a firm is an “individual partner” if the partner is an individual and “non-individual partner” is to be read accordingly; but “non-individual partner” does not include the firm itself where it is treated as a partner under section 863E.
- (7) B’s profit share is to be determined by applying section 850 and, if relevant, section 850A in relation to B for the relevant period of account (whether or not B is chargeable to income tax) on the assumption that the calculation under section 849 in relation to B produces the profit for the firm mentioned in subsection (1)(a)(i).
- (8) “A’s deferred profit” is any remuneration or other benefits or returns the provision of which to A has been deferred (whether pending the meeting of any conditions (including conditions which may never be met) or otherwise).
- (9) “The relevant tax amount” is the total amount of tax which, apart from this section, would be chargeable in respect of A and B’s income as partners in the firm.
- (10) “The appropriate notional profit” is the sum of the appropriate notional return on capital and the appropriate notional consideration for services.
- (11) “The appropriate notional return on capital” is –
  - (a) the return which B would receive for the relevant period of account in respect of B’s contribution to the firm were the return to be calculated on the basis mentioned in subsection (12), less
  - (b) any return actually received for the relevant period of account in respect of B’s contribution to the firm which is not included in B’s profit share.
- (12) The return mentioned in subsection (11)(a) is to be calculated on the basis that it is a return which is –

- (a) by reference to the time value of an amount of money equal to B's contribution to the firm, and
  - (b) at a rate which (in all the circumstances) is a commercial rate of interest.
- (13) For the purposes of subsections (11) and (12) B's contribution to the firm is amount A determined under section 108 of ITA 2007 (meaning of "contribution to the LLP").
- (14) That section is to be applied –
  - (a) reading references to the individual as references to B and references to the LLP as references to the firm, and
  - (b) with the omission of –
    - (i) subsections (5)(b) and (9), and
    - (ii) in subsection (6) the words from "but" to the end.
- (15) "The appropriate notional consideration for services" is –
  - (a) the amount which B would receive in consideration for any services provided to the firm by B during the relevant period of account were the consideration to be calculated on the basis mentioned in subsection (16), less
  - (b) any amount actually received in consideration for any such services which is not included in B's profit share.
- (16) The consideration mentioned in subsection (15)(a) is to be calculated on the basis that B is not a partner in the firm and is acting at arm's length from the firm.
- (17) Any services, the provision of which involves any partner in the firm in addition to B, are to be ignored for the purposes of subsection (15).
- (18) A has the power to enjoy B's profit share if –
  - (a) A is connected with B by virtue of a provision of section 993 of ITA 2007 (meaning of "connected" persons) other than subsection (4) of that section, or
  - (b) any of the enjoyment conditions is met in relation to B's profit share or any part of B's profit share.
- (19) The enjoyment conditions are –
  - (a) B's profit share, or the part, is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of A, whether in the form of income or not;
  - (b) the receipt or accrual of B's profit share, or the part, by or to B operates to increase the value to A of any assets held by, or for the benefit of, A;
  - (c) A receives or is entitled to receive at any time any benefit provided or to be provided (directly or indirectly) out of B's profit share or the part;
  - (d) A may become entitled to the beneficial enjoyment of B's profit share, or the part, if one or more powers are exercised or successively exercised by any person;
  - (e) A is able in any manner to control (directly or indirectly) the application of B's profit share or the part.

- (20) In subsection (19) references to A include any person connected with A apart from B.
- (21) Subsection (22) applies if –
  - (a) the increase under subsection (4), or any part of it, is allocated by A to the firm itself under section 863E, and
  - (b) B makes a payment to the firm representing any income tax for which the firm is liable by virtue of section 863E in respect of the amount of the increase allocated to it.
- (22) The payment is not to be taken into account in calculating any income of any person for income tax purposes.

**850D Excess profit allocation: cases involving individuals who are not partners**

- (1) Subsections (4) and (5) apply if –
  - (a) at a time during a period of account (“the relevant period of account”) in respect of a firm, an individual (“A”) personally performs services for the firm,
  - (b) if A had been a partner in the firm throughout the relevant period of account, the calculation under section 849 in relation to A for the relevant period of account would have produced a profit for the firm,
  - (c) a non-individual partner (“B”) in the firm (see subsection (6)) has a share of that profit (“B’s profit share”) which is a profit (see subsection (7)),
  - (d) it is reasonable to suppose that A would have been a partner in the firm at a time during the relevant period of account or any earlier period of account but for the provision contained in section 850C (see also subsections (8) to (10)), and
  - (e) condition X or Y is met.
- (2) Condition X is that it is reasonable to suppose that amounts representing A’s deferred profit (see subsection (11)) are included in B’s profit share.
- (3) Condition Y is that –
  - (a) B’s profit share exceeds the appropriate notional profit (see subsection (12)),
  - (b) A has the power to enjoy B’s profit share (“A’s power to enjoy”) (see subsection (13)), and
  - (c) it is reasonable to suppose that the whole or any part of B’s profit share is attributable to A’s power to enjoy.
- (4) A is to be treated on the following basis –
  - (a) A is a partner in the firm throughout the relevant period of account (but not for the purposes of section 863E),
  - (b) A’s share of the firm’s profit for the relevant period of account is so much of the amount of B’s profit share as, it is reasonable to suppose, is attributable to –
    - (i) A’s deferred profit, or
    - (ii) A’s power to enjoy,as determined on a just and reasonable basis, and



(c) A's share of the firm's profit is chargeable to income tax under the applicable provisions of the Income Tax Acts for the tax year in which the relevant period of account ends.

But A's share of the firm's profit by virtue of paragraph (b)(ii) is not to exceed the amount of the excess mentioned in subsection (3)(a) after deducting from that amount A's share of the firm's profit (if any) by virtue of paragraph (b)(i).

(5) If B is chargeable to income tax, in applying sections 850 to 850B in relation to B for the relevant period of account, such adjustments are to be made as are just and reasonable to take account of A's share of the firm's profit under subsection (4).

(This subsection does not apply for the purposes of subsection (7) or section 850C(7).)

(6) "Non-individual partner" is to be read in accordance with section 850C(6).

(7) B's profit share is to be determined by applying section 850 and, if relevant, section 850A in relation to B for the relevant period of account (whether or not B is chargeable to income tax) on the assumption that the calculation under section 849 in relation to B produces the profit for the firm mentioned in subsection (1)(b).

(8) The requirement of subsection (1)(d) is to be assumed to be met if, at a time during the relevant period of account, A is a member of a partnership which is associated with the firm.

(9) A partnership is "associated" with the firm if –  
 (a) it is a member of the firm, or  
 (b) it is a member of a partnership which is associated with the firm (whether by virtue of paragraph (a) or this paragraph).

(10) In subsections (8) and (9) "partnership" includes a limited liability partnership whether or not section 863(1) applies in relation to it.

(11) "A's deferred profit" is to be read in accordance with section 850C(8).

(12) Section 850C(10) to (17) applies for the purpose of determining "the appropriate notional profit"; and A is to be treated as a partner in the firm for the purposes of section 850C(17).

(13) Section 850C(18) to (20) applies for the purpose of determining if A has the power to enjoy B's profit share.

#### **850E Payment from B to A**

(1) Subsection (2) applies in a case in which section 850C(4) or section 850D(4) applies if –

(a) A and B have an agreement in relation to B's profit share,  
 (b) as a result of the agreement, out of B's profit share B makes a payment (directly or indirectly) to A which does not exceed the amount of the increase under section 850C(4) or the amount of A's share of the firm's profit under section 850D(4), and

(c) the payment is not made under any arrangements the main purpose, or one of the main purposes, of which is the obtaining of a tax advantage for any person.

- (2) The payment –
    - (a) is not to be taken into account in calculating any income of A or B for income tax purposes, and
    - (b) is not for any purpose of the Income Tax Acts to be regarded as a distribution.
  - (3) In subsection (1) –
    - “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable),
    - “B’s profit share” has the same meaning as in section 850C or 850D (as the case may be), and
    - “tax advantage” has the meaning given by section 1139 of CTA 2010.”
- 2 (1) Chapter 3 of Part 4 of ITA 2007 (trade loss relief: restrictions for certain partners) is amended as follows.
- (2) In section 102 (overview of Chapter) after subsection (2) insert –
    - “(2A) This Chapter also provides for no relief to be given for a loss made by an individual in a trade carried on by the individual as a partner in a firm in certain cases where some or all of the loss is allocated to the individual rather than a person who is not an individual (see section 116A).”
  - (3) At the end insert –

*“Partnerships with mixed membership etc*

**116A Excess loss allocation to partners who are individuals**

- (1) Subsection (2) applies if –
  - (a) in a tax year, an individual (“A”) makes a loss in a trade as a partner in a firm, and
  - (b) A’s loss arises, wholly or partly –
    - (i) directly or indirectly in consequence of, or
    - (ii) otherwise in connection with, relevant tax avoidance arrangements.
- (2) No relevant loss relief may be given to A for A’s loss.
- (3) In subsection (1)(b) “relevant tax avoidance arrangements” means arrangements –
  - (a) to which A is party, and
  - (b) the main purpose, or one of the main purposes, of which is to secure that losses of a trade are allocated, or otherwise arise, in whole or in part to A, rather than a person who is not an individual, with a view to A obtaining relevant loss relief.
- (4) In subsection (3)(b) references to A include references to A and other individuals.
- (5) For the purposes of subsection (3)(b) it does not matter if the person who is not an individual is not a partner in the firm or is unknown or does not exist.

- (6) In this section –  
 “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and  
 “relevant loss relief” means –
- (a) sideways relief,
  - (b) relief under section 83 (carry-forward trade loss relief),
  - (c) relief under section 89 (terminal trade loss relief), or
  - (d) capital gains relief.
- (7) This section applies to professions as it applies to trades.”

- 3 (1) Chapter 4 of Part 4 of ITA 2007 (losses from property businesses) is amended as follows.
- (2) In section 117 (overview of Chapter) in subsection (3) for “and 127B” substitute “to 127C”.
- (3) After section 127B insert –

**“127C Excess loss allocation to partners who are individuals**

- (1) Subsection (2) applies if –
- (a) in a tax year, an individual (“A”) makes a loss in a UK property business or an overseas property business as a partner in a firm, and
  - (b) A’s loss arises, wholly or partly –
    - (i) directly or indirectly in consequence of, or
    - (ii) otherwise in connection with, relevant tax avoidance arrangements.
- (2) No relevant loss relief may be given to A for A’s loss.
- (3) In subsection (1)(b) “relevant tax avoidance arrangements” means arrangements –
- (a) to which A is party, and
  - (b) the main purpose, or one of the main purposes, of which is to secure that losses of a UK property business or an overseas property business are allocated, or otherwise arise, in whole or in part to A, rather than a person who is not an individual, with a view to A obtaining relevant loss relief.
- (4) In subsection (3)(b) references to A include references to A and other individuals.
- (5) For the purposes of subsection (3)(b) it does not matter if the person who is not an individual is not a partner in the firm or is unknown or does not exist.
- (6) In this section –  
 “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and

“relevant loss relief” means relief under section 118 (carry-forward property loss relief) or section 120 (property loss relief against general income).”

- 4 (1) Part 17 of CTA 2009 (partnerships) is amended as follows.
- (2) In section 1262 (allocation of firm’s profits and losses between partners) in subsection (1) for “and 1264” substitute “to 1264A”.
- (3) After section 1264 insert –

**“1264A Excess profit allocation to non-individual partners etc**

- (1) Subsection (2) applies in a case in which –
- (a) section 850C(4) or 850D(4) of ITTOIA 2005 applies for a period of account (“the relevant period of account”), and
- (b) the partner who is “B” for the purposes of section 850C or 850D of that Act (as the case may be) is a company.
- (2) In applying sections 1262 to 1264 in relation to the company –
- (a) for the accounting period of the firm which coincides with the relevant period of account, or
- (b) if no accounting period of the firm coincides with the relevant period of account, for accounting periods of the firm in which the relevant period of account falls,
- such adjustments are to be made as are just and reasonable to take account of the increase under section 850C(4) of ITTOIA 2005 or A’s share of the firm’s profit under section 850D(4) of that Act.
- (3) If relevant, sections 850C(21) and (22) and 850E of ITTOIA 2005 apply for corporation tax purposes as they apply for income tax purposes.”

*Commencement*

- 5 The amendments made by paragraphs 1 and 4 are treated as having come into force on 5 December 2013 and have effect in accordance with paragraphs 6 and 7.
- 6 (1) Section 850C of ITTOIA 2005 has effect for periods of account beginning on or after 6 April 2014 (and section 850E of ITTOIA 2005 and section 1264A of CTA 2009 have effect accordingly).
- (2) Sub-paragraphs (3) and (4) apply in relation to a firm where a period of account (“the straddling period”) begins before 6 April 2014 but ends on or after that date.
- (3) Assume that the part of the straddling period falling on or after 6 April 2014 is a separate period of account.
- (4) If section 850C(4) of ITTOIA 2005 would apply in relation to one or more partners in the firm for the assumed separate period of account, Part 9 of that Act has effect as if that part of the straddling period were a separate period of account.
- 7 (1) Section 850D of ITTOIA 2005 has effect for periods of account beginning on or after 6 April 2014 (and section 850E of ITTOIA 2005 and section 1264A of CTA 2009 have effect accordingly).

- (2) Sub-paragraphs (3) and (4) apply in relation to a firm where a period of account (“the straddling period”) begins before 6 April 2014 but ends on or after that date.
  - (3) Assume that the part of the straddling period falling on or after 6 April 2014 is a separate period of account.
  - (4) If section 850D(4) of ITTOIA 2005 would apply in relation to one or more individuals for the assumed separate period of account, Part 9 of that Act has effect as if that part of the straddling period were a separate period of account.
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- (1) The amendments made by paragraphs 2 and 3 have effect in relation to losses made in the tax year 2014-15 and subsequent tax years.
  - (2) Sub-paragraphs (3) and (4) apply for the purposes of section 116A or 127C of ITA 2007 if a loss made by an individual as a partner in a firm arises in a period of account (“the straddling period”) which begins before 6 April 2014 but ends on or after that date.
  - (3) The loss is to be apportioned between the part of the straddling period falling before 6 April 2014 and the part falling on or after that date –
    - (a) on a time basis according to the respective lengths of those parts of the straddling period, or
    - (b) if that method produces a result that is unjust or unreasonable, on a just and reasonable basis.
  - (4) Section 116A or 127C of ITA 2007 does not apply in relation to the loss so far as it is apportioned to the part of the straddling period falling before 6 April 2014.

## EXPLANATORY NOTE

### PARTNERSHIPS WITH MIXED MEMBERSHIPS

#### SUMMARY

1. Clause [a] and Schedule [b] counter tax advantages arising to individuals in partnership with persons who are not individuals (mixed membership partnerships) by way of excess allocations of profits or losses to certain members.

#### DETAILS OF THE SCHEDULE

2. Paragraph (1)(3) inserts new sections 850C to 850E into Part 9 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

3. Subsection (1) of new section 850C provides that the consequences in subsections (4) and (5) apply in the circumstances where an individual (“A”) is a partner in a firm that has a profit for a relevant period of account and a non-individual partner (“B”) has a profit share and either of conditions X or Y is met.

4. Subsections (2) and (3) of new section 850C detail conditions X and Y. Condition X relates to where A’s profit is deferred. Condition Y relates to where A has the power to enjoy B’s profit share.

5. Subsection (4) of new section 850C provides the consequences for A if the circumstances and conditions in subsection (1) are met. It explains how A’s profit share is to be increased by the amount of B’s profit share that can reasonably be supposed to be attributable to A’s deferred profit or A’s power to enjoy B’s profits. The increase in the case of A’s power to enjoy B’s profits is not to be more than the amount by which B’s profit share exceeds B’s appropriate notional profit, less any amount that is attributable to A’s deferred profit. B’s appropriate notional profit is calculated by reference to B’s appropriate notional return on capital (as defined in subsection (11)) and appropriate notional consideration for services (as defined in subsection (15)).

6. Subsection (5) of new section 850C provides the consequences for B if the circumstances and conditions in subsection (1) are met and B is subject to income tax. In determining B’s profit for a period of account adjustments are to be made to reflect the increase in A’s profit share on a just and reasonable basis.

7. Subsection (6) of new section 850C defines an “individual partner” and “non-individual partner”. A “non-individual” would include, for example, a company or an individual acting as a trustee.

8. Subsection (7) of new section 850C specifies that B's profit share is to be determined by reference to the income tax rules for calculating a partner's profit share. This is the case whether B is chargeable to income tax or corporation tax.
9. Subsection (8) of new section 850C defines the term "A's deferred profit" used in condition X.
10. Subsection (9) of new section 850C defines the term "the relevant tax amount" used in conditions X and Y.
11. Subsection (10) of new section 850C defines the term "the appropriate notional profit" used in condition Y as the sum of the appropriate notional return on capital and the appropriate notional consideration for services.
12. Subsections (11) and (12) of new section 850C define the term "the appropriate notional return on capital" used in subsection 10 and specify how it is to be calculated by reference to B's contribution to the firm.
13. Subsections (13) and (14) of new section 850C specify how the amount of B's contribution to the firm for the purposes of subsections (11) and (12) is to be determined.
14. Subsections (15) to (17) of new section 850C define the term "the appropriate notional consideration for services" used in subsection 10 and specify how it is to be calculated.
15. Subsection (18) of new section 850C details the circumstances in which A has the power to enjoy B's profit share. This is the case if A is a connected person in relation to B, other than being connected by reason of being partners in the partnership, or if any of the enjoyment conditions specified in subsection (19) are met in relation to all or part of B's profit share.
16. Subsection (19) of new section 850C details the enjoyment conditions.
17. Subsection (22) of new section 850C applies where all or part of the increase in A's profit share is allocated by A to the firm under new section 863E of ITTOIA 2005, which modifies the rules for the taxation of partnerships that manage Alternative Investment Funds, and B makes a payment representing income tax to the firm. The payment is disregarded in calculating any income of any person for income tax purposes.
18. Subsection (1) of new section 850D provides that the consequences in subsections (4) and (5) apply in the circumstances where a non-individual partner ("B") has a profit share for a relevant period of account, and individual ("A") personally performs services for the firm, it is reasonable to suppose that A would have been a partner in the firm but for the rules in new section 850C and either of conditions X or Y is met.
19. Subsections (2) and (3) of new section 850D set out conditions X and Y. Condition X relates to amounts representing A's deferred profit in B's profit share. Condition Y relates to where A has the power to enjoy B's profit share.

20. Subsection (4) of new section 850D provides the consequences for A if the circumstances and conditions in subsection (1) are met. A is treated as a partner in the firm for the relevant period of account, except for the purposes of new section 863E of ITTOIA 2005, and as having a share of the firm's profit for the relevant period of account which is chargeable to income tax. A's share of the profit is the amount of B's profit that can reasonably be supposed to be attributable to A's deferred profit or A's power to enjoy B's profits. A's share of the profits is not to be more than the amount by which B's profit share exceeds B's appropriate notional profit, less any amount that is attributable to A's deferred profit. B's appropriate notional profit is determined in the same way as in new section 850C of ITTOIA 2005.
21. Subsection (5) of new section 850D provides the consequences for B if the circumstances and conditions in subsection (1) are met and B is subject to income tax. In determining B's profit share for a period of account adjustments are to be made to reflect A's share of the firm's profit on a just and reasonable basis.
22. Subsection (7) of new section 850D specifies that B's profit share is to be determined by reference to the income tax rules for calculating a partner's profit share. This is the case whether B is chargeable to income tax or corporation tax.
23. Subsection (8) of new section 850D provides an automatic assumption in relation to a member of a partnership which is associated with the firm. The assumption is that it is reasonable to suppose that the member would have been a partner in the firm at a time during the relevant period of account, or an earlier period of account, but for the provision contained in new section 850C of ITTOIA 2005.
24. Subsection (9) of new section 850D provides the circumstances in which a partnership is "associated" with the firm.
25. Subsection (1) of new section 850E applies subsection (2) if new section 850C(4) of ITTOIA 2005 applies to increase A's profit share, or new section 850D(4) of ITTOIA 2005 applies to treat A as having a share of the firm's profit, and as a result of an agreement in relation to B's profit share, B makes payment to A which does not exceed the amount of the increase of A's profit share or the amount treated as A's share of the firm's profit. This is subject to the payment not being made with a main purpose of obtaining a tax advantage.
26. Subsection (2) of new section 850E provides that a payment is not to be income of A or B, or a distribution, for income tax purposes.
27. Subsection (3) of new section 850E provides definitions relevant to subsection (1).
28. Paragraphs 2(1) and 2(2) amend the overview of Chapter 3 of Part 4 of Income Tax Act 2007 (ITA 2007).
29. Paragraph 2(3) inserts new section 116A into Chapter 3 of Part 4 of ITA 2007.



30. Subsections (1) to (5) of new section 116A provide that no relevant loss relief is to be given to an individual for a loss made in a trade or profession as a partner where the individual is party to arrangements with a main purpose of ensuring that losses are allocated, or otherwise arise, to the individual, or individuals, rather than a non-individual, with a view to the individual obtaining relevant loss relief. For the purpose of this section it does not matter if the entity who is the non-individual is yet to be formed or participate in the partnership.
31. Subsection (6) of new section 116A defines “arrangements” and “relevant loss relief” for the purposes of this section.
32. Paragraphs 3(1) and 3(2) amend the overview in Chapter 4 of Part 4 of ITA 2007.
33. Paragraph 3(3) inserts new section 127C into Chapter 4 of Part 4 of ITA 2007.
34. Subsections (1) to (5) of new section 127C provide that no relevant loss relief is to be given to an individual for a loss made in a property business as a partner where the individual is party to arrangements with a main purpose of ensuring that losses are allocated, or otherwise arise, to the individual, or individuals, rather than a non-individual, with a view to the individual obtaining relevant loss relief. For the purpose of this section it does not matter if the entity who is the non-individual is yet to be formed or participate in the partnership.
35. Subsection (6) of new section 127C defines “arrangements” and “relevant loss relief” for the purposes of this section.
30. Paragraphs 4(1) and 4(2) amend Part 17 of the Corporation Tax Act 2009 (CTA 2009).
31. Paragraph 4(3) inserts new section 1264A into Part 17 of CTA 2009.
32. Subsections (1) and (2) of new section 1264A provide for the situation where the income tax provisions in new sections 850C(4) or 850D(4) of ITTOIA 2005 apply to increase individual A’s profit share, or to treat A as having a share of the firm’s profit, and a company is non-individual B in relation to A. In determining the company’s profits from the firm for an accounting period adjustments are to be made to reflect the increase in A’s profit share, or the amount of profit treated as A’s share of the firm’s profit, on a just and reasonable basis.
33. Subsection (3) of new section 1264A makes corresponding provision for corporation tax in respect of sections 850C(21) and (22) and section 850E of ITTOIA 2005.
34. Paragraphs 5 to 8 provide commencement rules. The changes will take effect from 6 April 2014 with the exception of anti-avoidance rules concerning tax-motivated profit allocations. These rules come into force on 5 December 2013 in order to protect against risks to tax revenue.

**BACKGROUND NOTE**

35. This change is part of a wider review of certain parts of the partnership rules announced in Budget 2013. A consultation document, *Partnerships: A review of two aspects of the tax rules*, was published on the gov.uk website on 20 May 2013 and the consultation closed on 9 August 2013.

36. This element of the partnerships review measure is discussed in the consultation document under the headings: *Partnerships with mixed membership – profits and Partnerships with mixed membership - losses*.

37. If you have any questions about this change, or comments on the legislation, please contact James Ewington on 03000 553788 (email: [partnership.review@hmrc.gsi.gov.uk](mailto:partnership.review@hmrc.gsi.gov.uk)).