Office of
Tax Simplification

Review of partnerships: final report

January 2015

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Foreword

This is the OTS's third and – for the moment at least – final report on the subject of the taxation of Partnerships. This continues to be an interesting area for us to work on, not least because of the range of business situations that partnerships are used for. Indeed, we would reiterate some of the key themes from our interim report:

- partnerships constitute some 10% of UK businesses, but don't seem to get a concomitant level of attention from policy makers and tax administrators;
- partnerships are not just used for small, simple businesses but have been found to be ideal for many international arrangements;
- there needs to be more positive engagement with partnerships' tax issues, from the smallest to complex financing structures, to help facilitate their use;
- the UK's partnerships system is a useful additional device to attract investors in business ventures, both property and generally;
- above all, though nobody would deny that partnerships have been used for tax avoidance purposes, their main use is and always has been for enterprise and this deserves support and encouragement, from tax and general business policymakers.

In the months since the publication of our second report, we have worked with HMRC partnerships experts on a number of aspects and are pleased to see the progress that has been made on a range of our recommendations. We include in this report an update on their progress in taking forward our interim recommendations.

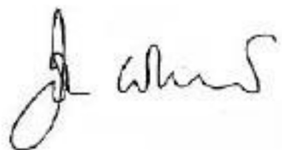
Our work in recent months has been focused on the topics that we identified in our July report, ranging from Education for small partnerships through a potential recast of HMRC's Statement of Practice D12 to identifying specific International issues that need to be tackled. We are very grateful to the organisations and specialists who have contributed to this work, in meetings and through often lengthy submissions. All of these have been studied carefully and have been of material help to us: as always, our work is totally dependent on the wide range of external contributions we receive (and by external we mean external to the OTS: we have received much useful input from HMRC's partnerships' teams).

In some areas, particularly partners' expenses but also with gift aid, we are aware that our recommendations are not accepted by HMRC. They feel we have put forward ideas that conflict with key partnership principles, in particular the difference between the partners and the partnership. Thus expenses must be incurred by the firm and gift aid donations made by individuals rather than, as we have recommended, allowing partnerships the option of having partners claim expenses against their own profit share or the gift aided donations treated as made by the firm. We have made our recommendations in line with our mandate to develop ideas for simplification, drawing in the evidence we have gathered of what is happening in practice and what would help partnerships. We do not believe there are any insurmountable problems here.

The members of our Consultative Committee have continued to give us valuable input and guidance, and have facilitated a number of further specialist meetings. Roger Jones and Martin Gunson, who led the work on the initial project, have continued to offer wise counsel and

editing assistance. But the main thanks have to go to Gareth Jones and Andy Richens who have steered the work on this final stage of the project.

The OTS believes that our conclusions and further recommendations have the potential to make a useful, positive difference to the tax system as it affects partnerships of all shapes and sizes. We commend our report to policymakers and we will continue to take a close interest in how our proposals are taken forward.



John Whiting

OTS Tax Director

January 2015

List of recommendations

Chapter 1 Introduction

We repeat two recommendations from our Interim report:

1 HMRC needs to establish a 'Head of Partnerships' role to help ensure proper focus of tax policy and operational work.

2 There is a need for an industry/HMRC liaison group to provide a forum to address issues arising from new, specialist partnership uses. HMRC's initial suggestion of using the Working Together network for this purpose is impractical.

Chapter 2 Education and support for smaller partnerships

3 The introduction of clear and comprehensive guidance for partnerships at the point of registration, with efficient signposting and links to the HMRC initiatives outlined and the Department for Business, Innovation and Skills (BIS) guidance material.

4 HMRC and BIS jointly to provide a checklist of issues that need to be considered in a partnership agreement, with commentary and examples.

Chapter 3 Partners' expenses

5 Allowing partners to claim their allowable expenses incurred from their share of the profits, where the partnership agreement is set out on this basis.

Chapter 4 International issues

6 Future Double Tax Agreement renegotiations to have a requirement to consider partnerships and the issues mentioned in our reports.

7 The position on composite returns to be formalised to provide certainty. We think an HMRC Statement of Practice could cover this, rather than primary legislation.

8 The guidance on procedures to obtain a Unique Taxpayer Reference (UTR) is within the Self Assessment Manual[1], and the OTS recommend that this be clearly linked from the Partnership Manual.

9 If there is no policy reason for keeping employees of partnerships from accessing the short term business visitor exemption, it would be useful to formalise their access to this exemption.

10 The alignment of the tax rules in the area of foreign exchange for partnerships should be pursued, but if it is considered that such changes would be too difficult to effect, then at a minimum HMRC should publish clear guidance on the area.

11 The omission of partners from the legislation on remittances from mixed funds should be corrected.

[1] HMRC Self-Assessment Manual SAM 100137

Chapter 5 Group structures with LLP members

12 The OTS recommend clear guidance be included in the Partnership Manual to address the area of Group Relief on structures involving LLPs, which we understand HMRC have agreed to.

Chapter 6 Capital gains tax

13 The timing of the publication of an updated HMRC Statement of Practice D12 could be used by both HMRC and the tax profession to launch seminars and releases in order to raise awareness of the statement and its relevance.

14 Full clarification on the questions raised by the Professional Bodies[2] on entrepreneurs' relief to be included within the Partnership Manual.

Chapter 7 Gift aid and partnerships

15 Whether or not the OTS's main recommendation, which follows, is accepted, HMRC guidance needs to be amended to reflect the correct legal position, assuming HMRC is not prepared to continue with it as a concessionary treatment.

16 Introduction of two alternative routes to gift aid to be available to partnerships:

a The firm may make a donation and the relevant gift aid declaration is made by the representative partner. The donation would be treated as made under gift aid by the individual partners with the charity entitled to reclaim the basic rate income tax.

b The firm may simply take a deduction for the donation in its computation of trading profits. In this case it would be treated as a gross donation with no eligibility for the charity to reclaim basic rate tax, in parallel to the gift aid system for companies.

Chapter 8 Other issues

17 Recommendations in the Interim report on reducing VAT reporting, legislative change to allow mixed member partnerships to claim the annual investment allowance, and simplifying basis periods for trading and other income, are repeated in this report.

[2] Set out in Annex B

1 Introduction

Background

1.1 In January 2014, the Office of Tax Simplification (OTS) issued an Interim Report[1] on its Review of Partnerships. The report set out a number of emerging key themes, and produced recommendations for simplification under three headings:

- short term fixes,
- medium term proposals, and
- longer term areas for investigation.

1.2 HMRC responded to each of these, and in July 2014 the OTS published an Update Report[2] setting out the areas where further work was being undertaken, and calling for evidence to test the HMRC response on those matters where we didn't agree.

Final report

1.3 Based on the further submissions and evidence we have received, this report sets out the OTS proposals on:

- Better education and support for smaller partnerships;
- The ability for partners to claim allowable partnership expenses in their own self-assessment return;
- Uncertainties around international issues;
- The taxation of group structures held by or including a Limited Liability Partnership (LLP);
- An update on capital gains tax and HMRC's Statement of Practice D12; and
- Proposals on gift aid for partnerships.

1.4 At the same time, we are pleased to acknowledge the progress HMRC have made on many of our original proposals. We noted in our Update Report that the publication of the consolidated Partnership Manual will save considerable time in trawling through the HMRC guidance. Further guidance on VAT registration involving limited partnerships and joint ventures, and VAT grouping for LLPs is now available, but not yet linked to the Partnership Manual.

1.5 We will continue to work with HMRC to see the following areas through to inclusion in the manual:

- eligibility for Entrepreneurs' Relief

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/274278/PU1619_OTS_Partnerships_Interim_report.pdf

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/336713/OTS_review_of_partnerships_update_and_call_for_evidence.pdf

- Stamp Duty Land Tax (SDLT) liabilities following changes in profit share ratios
- inheritance tax for partnerships

1.6 Our initial report noted that HMRC has no partnerships customer directorate, nor is there a senior civil servant with overall responsibility for partnerships across the range of taxes. We recommended that such a 'Head of Partnerships' role be created and, whilst we note HMRC's response in the Interim Report, we have to report that responses continue to call for such an approach. We agree with respondents on this issue and so we have to repeat our previous recommendation. We see it as ensuring there is proper focus on partnerships in tax policy matters and responding properly to the perhaps key finding of our first report: the significant proportion of UK business that is conducted through partnerships and the regular findings that legislation seems to deal with them as an afterthought, if at all.

1.7 Related to that point was a recommendation for the establishment of a joint industry/HMRC liaison group to monitor and discuss new arrangements using partnerships in business structures. We had in mind the various financing and investment structures we have seen which we termed 'specialist partnerships' in our report. We were told that these sometimes create uncertainties around tax treatment and also can arouse HMRC suspicions unnecessarily; these comments have been repeated in a few of our recent meetings. A liaison group would allow these issues to be discussed early in the process and in a constructive environment.

1.8 HMRC's response to this liaison group recommendation was that it could be accommodated within the existing Working Together (WT) structure. WT is undoubtedly a valuable and important system but to ask it – essentially a network of small, local practitioners and HMRC – to deal with specialist partnership matters is completely wrong. There needs to be a specialist forum and so we repeat the recommendation.

1.9 On Stamp Taxes, a member of our Consultative Committee has joined the Steering Group, with a view to continue to work with HMRC on clarifying the issues identified.

1.10 The final chapter picks up the progress on the remaining areas from our July progress report, i.e. double reporting of income figures, VAT reporting requirements, the Annual Investment Allowance and mixed member partnerships, and simplifying basis periods for both trading income and other income.

1.11 Although this report is badged as our Final Report on Partnerships, it may be appropriate for the OTS to do short follow-up reports, probably in conjunction with HMRC, as our recommendations are progressed.

2 Education and support for smaller partnerships

Background to small business support

2.1 In February 2012, the OTS published a Final Report under its Small Business Review on HMRC Administration[1]. As part of the research that led to the report, the OTS and HMRC jointly commissioned an independent company to survey small business[2].

2.2 The survey showed many of these businesses experienced significant levels of fear, anxiety and uncertainty about their tax matters[3]. The OTS heard from many small businesses who felt HMRC did not offer enough help to understand and manage their own tax affairs. Following the relatively straightforward process of registering the business, they then felt left on their own.

2.3 Alongside and following that report, HMRC have introduced a number of new initiatives aimed at helping new and existing businesses, including:

- setting up business and self-employed[4] guidance, information and tools targeted at pre-start up and start-up businesses, which brings together tax and non-tax assistance for new businesses and for businesses at key points
- an online registration service: registration for main business taxes in a single internet visit
- Business Tax Dashboard: the ability (for taxpayers but not yet their agents) to view liabilities and payments for income tax, class 2 and 4 NIC, PAYE and corporation tax
- help through free business advice emails, HMRC webinars, HMRC e-learning and tax information videos available on YouTube

2.4 However, signing up for the help and support functions in the final bullet above is via the HMRC website[5], and there is no obvious signposting from the setting up in business guidance. The OTS suggest that the movement of the HMRC website to the Gov.uk domain is an opportunity to better advertise the facilities currently available to business.

2.5 It also appears that the email facility is not particularly targeted, with little or no filtering for type of business, or the point in its lifecycle. For example, a new business starting up early in 2014 will not have to pay income tax/class 4 national insurance until the due date of 31 January 2015. However, we are aware that such a business received two or three emails reminding them that payments were required on 31 July 2014. Whilst the emails did say that this payment may not refer to them, and referred to HMRC learning aids, it clearly could cause confusion for the unrepresented business. Better advice in this case would have been for the business to ensure it

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1 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/199179/01_ots_small_business_tax_review_hmrc_administration_280212.pdf

2 Over 1,100 businesses were sampled in quantitative work, all with turnover below £1 million. The vast majority were unrepresented.

3 54% of those surveyed worried about making mistakes, even though they kept full records and took care. The proportion of those with agents who worried was 45%.

4 https://www.gov.uk/browse/business/setting-up

5 http://www.hmrc.gov.uk/startingup/help-support.htm

will have the funds available to meet the liability that will be due the following January. HMRC have told us that they plan to deploy a much more sophisticated service, utilising an Enterprise Data Platform and the 'Your Tax Account', with the aim by the end of 2016 of issuing sensitive prompts from the 'Your Tax Account', with generic but focused help continuing by email.

Smaller partnerships

2.6 One business advised us that having registered as a partnership online, they were left unsure what to do next. This echoes feedback that the OTS were receiving two to three years ago, and suggests that awareness is still lacking on the availability of the latest initiatives.

2.7 The starting point for a new business (possibly following a Google or equivalent search) would normally be the setting up business and self-employed guidance referred to above, on the Gov.uk website. The OTS considers this should be the place to fully explain the different forms of business, setting out the compliance implications for each.

2.8 There is a particular need to focus on the 'accidental' partnership situation, where two or more people are working together without appreciating that in tax terms they are in partnership. This has been identified as a significant issue among those on lower incomes. However, the link to 'running a partnership'[6] contains very limited material, and makes no reference to a partnership agreement at all.

2.9 Further, the wording of the overview page on business structures[7] appears to imply a partnership is an elective option, rather than defined by the facts.

2.10 The introduction of the consolidated HMRC Partnership Manual is excellent news for advisers in particular. However, unrepresented small partnerships may find this overwhelming, and currently have limited other guidance available.

2.11 **The OTS recommends the introduction of clear and comprehensive guidance for partnerships at the point of registration, with efficient signposting and links to both the HMRC initiatives outlined above and the Department for Business, Innovation and Skills (BIS) guidance material.**

Partnership model agreement

2.12 The OTS Interim Report on Partnerships set out the views of some of our stakeholders that it would be beneficial to have access to a default partnership agreement, by updating the 1890 Partnership Act whose provisions would apply unless displaced by an actual agreement.

2.13 HMRC responded that they had discussed the proposal internally as well as with BIS. They had reservations about publishing a draft model partnership agreement at least in part because of risk concerns. HMRC felt that the structure of commercial arrangements between parties was a matter for those parties themselves, drawing on expert professional advice as necessary. HMRC indicated that they would look to publish guidelines outlining key areas that should be considered as part of an agreement.

2.14 The OTS understands this view, but feels that under the system of self-assessment, it is equally necessary to educate and support the smaller businesses with help as far as possible. In our Progress Report on Partnerships, we asked for views on whether BIS should publicise a draft partnership agreement, or if the proposed list of pointers were sufficient. Some responded that they would like to see a draft agreement, but others felt that such a one size fits all approach

[6] https://www.gov.uk/set-up-business-partnership

[7] https://www.gov.uk/business-legal-structures/overview

would not be helpful, and could be dangerous for businesses relying on such a document without professional advice.

2.15 On balance, **the OTS concludes the best solution would be for HMRC and BIS jointly to provide a checklist of issues that need to be considered in a partnership agreement, with commentary and examples**, with links from the online guidance and HMRC Partnership Manual. As well as this material being seen as a joint responsibility of HMRC and BIS, we think that the Department for Work and Pensions (DWP) also need to be involved.

2.16 In Annex A we set out the main areas that a small trading partnership would need to consider within such an agreement, which we would like to see included within the above guidance.

3 Partners' expenses

Background

3.1 The OTS Interim Report set out the views we had received, that allowing partners to make personal claims for business related expenses incurred wholly and exclusively against their partnership share, would be extremely beneficial.

3.2 This would mean that, for many partnerships, the partnership returns could be finalised and submitted more quickly. There would be less need for multiple agents acting for different partners to liaise. It would also be simpler to understand for many partners, and better reflect the reality of what was happening.

3.3 HMRC rejected the recommendation on the grounds that this would add further significant burdens to the administration of partnerships and partners, and not reflect the true profit or loss of the partnership business or the individual partners. They also considered this may have significant Exchequer costs and raise compliance issues.

3.4 HMRC's view of the legislation[1] is that relief for partners who incur expenses wholly and exclusively for the purposes of the partnership business, can only be claimed as a deduction in arriving at the profits of the partnership business. HMRC hold a similar view on expenditure incurred by partners qualifying for capital allowances.

3.5 We noted in our Interim Report that this interpretation is currently subject to litigation[2]. We referred to this appeal since it concerned the ability of a member of a partnership to claim a deduction, from his share of the partnership trade profit, of expenses incurred wholly and exclusively for the purpose of that trade. It concerned a settlement payment relating to a former membership of a separate LLP, in order to continue as a member of the latter LLP. It should be noted that our proposals, whilst related, do not go as far as the facts in this case, since we are only looking at expenses incurred by the partners, wholly and exclusively for the purpose of the partnership business as a whole.

3.6 In our Progress Report in July 2014, the OTS called for evidence in response, asking:

- whether individual partners are currently put off claiming expenses wholly and exclusively incurred,
- would allowing individuals to claim such expenses on their own return increase or reduce complexity, and
- whether this would mean adjustments would be necessary through the partnership accounts, bearing in mind the need for LLPs to produce and file accounts.

This would be an optional, not a compulsory treatment.

[1] HMRC's Business Income Manual BIM 82075

[2] The First Tier Tribunal found against HMRC (Vaines v HMRC UKFTT 576) with the appeal heard by the Upper Tribunal in September 2014.

Call for evidence responses

3.7 Respondents felt that individual partners are indeed being put off claiming. It was considered any increased Exchequer cost should not be a reason to deny change to ease the claim process, where such expenses are wholly and exclusively incurred. Many noted that any increased cost would only represent giving relief for valid expenses which is currently, wrongly, not being accessed.

3.8 On the HMRC point that allowing partners to claim expenses would not reflect the true partnership profit, we heard that partnerships have always had flexible profit share arrangements and if partners choose to operate their business in this manner, then that should be a matter for them. A body representing many medical practices where partners' expenses are particularly relevant, rejected HMRC's assertion that it would not give a true reflection of performance of the business. They give an example where the business is up for sale, saying that, the first thing necessary would be to strip out the proprietors' expenses of the partnership that are incurred personally. Most, if not all, of benchmarking examines the accounts figure only, as the partners' expenses can vary wildly and would skew the results. If anything, therefore, the lack of the partners' expenses gives a more accurate picture of how the business performs.

3.9 On compliance, we heard that putting the expenses on the individual's tax return would enable HMRC to have more scope to enquire into partners' expenses. At the moment including all the claims together in the partnership could hide excess claims. Such a change would make the individual partners more responsible for what they are claiming and what is appearing on their tax returns. The partnership pages could be disposed of and instead use the self-employment pages. There could be an additional box in the income section to say this is from a business activity carried on in partnership with others. It was considered this would be much clearer for the individual taxpayer to understand. This point is also considered under the "Other issues" section of this report.

3.10 On the point of finalising the partnership affairs, we were told there are often some recalcitrant partners who won't provide details of their personal expenses until January, and it does hold up the finalisation of the partnership accounts, the partnership tax return and thus the personal tax returns of their more disciplined colleagues.

3.11 However, one respondent did like an aspect of the current system, in that it enabled the partnership to determine what is and isn't a partnership expense, giving better discipline and control. Our proposal for allowing claims by individual partners would not lose this route as an option.

3.12 We were given a range of examples of the types of expenses that it would be helpful to be able to claim directly. These included:

- travel expenses, particularly motor expenses
- conference attendance
- books and journals

3.13 The point often made was that although such items would rank as expenses of the firm, in some cases there is a measure of personal choice over the car to use, the conference to attend or the book to buy. In such cases, the other partners were sometimes unhappy to be forced to share the cost through the charge via the partnership return, as required by HMRC.

3.14 Responses were mixed on whether allowing individual partners to claim expenses would mean adjustments would be necessary through the accounts. The OTS concludes such an adjustment in the accounts would not be necessary as this would follow the current HMRC practice[3] of accepting adjustments for expenditure, and then treating the expenditure as if it had been included in the accounts. Similarly, allowances can be made for capital allowances that do not feature in the accounts.

Current practice where agreement allows partners' expenses to be taken into account

3.15 HMRC helpsheet 231[4], dealing with doctors' expenses, acknowledges some partnership agreements provide that any expenditure incurred by a partner on behalf of the partnership, or any capital allowances due on assets owned by the partner, should be taken into account when the net profit of the practice is shared between the partners.

3.16 However, because HMRC take the view that the only legal basis for such expenditure is as a deduction in the calculation of the profits of the partnership business, a complex series of adjustments are deemed necessary, i.e.

- deduct all allowable expenditure and capital allowances (incurred both at partnership and partner level) from the partnership profits
- add back the allowable expenditure and capital allowances incurred by the individual partners
- allocate the profit share (before individual adjustments)
- deduct the allowable expenditure and capital allowances incurred by the individual partners

3.17 The HMRC helpsheet sets out the following example:

[3] See helpsheet 231

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/323591/hs231.pdf

Box 3.A: Example from HMRC helpsheet

Doctors John, Hook and Feelgood carry on a health centre practice in partnership together. Their partnership agreement needs profits to be shared 50:30:20 but each partner is entitled to an adjustment for any expenditure incurred on behalf of the partnership. No other 'fixed adjustments' are due.

The partnership accounts for the 12 months to 31 December 2013 include entries for:

Employee costs £24,000

Premises costs £12,000

Motor expenses £7,500

The capital allowances due on the vehicles are £3,750.

The three doctors bear the full running costs of their own private cars, although they use vehicles in the practice. For the 12 months to 31 December 2013 the running costs attributable to the practice were:

John	Hook	Feelgood
£4,000	£2,400	£1,900

Capital allowances are due (based on separate pools and adjusted for private usage) as follows:

£1,750	£1,420	£3,460

In addition, Dr John runs a small satellite surgery at home which is part of the partnership practice. Although the practice bears some of the costs directly, Dr John incurs some costs himself. These are:

Proportion of home running costs £1,500

Wife's wages and pension payments £8,000

Entries in the 2013/14 Partnership Return

When completing the trading pages of the Partnership tax return for 2013/14, the following composite entries are needed:

Employee costs £24,000 +£8,000 = £32,000 box 3.51

Premises costs £12,000 + £1,500 = £13,500 in box 3.52

Motor expenses £7,500 + £4,000 + £2,400 + £1,900 = £15,800 in box 3.55

Capital allowances £3,750 + £1,750 + £1,420 + £3,460 = £10,380 in box 3.70

The net taxable profit (box 3.73) returned by the partnership for the 12 months to 31 December 2013 was £120,000. This is allocated as follows:

Step 1: adjust for expenditure incurred by the individual partners

Net taxable profit	£120,000
Add back: running costs of cars	£ 8,300
Capital allowances	£ 6,630
Surgery costs	£ 9,500
Profit shared before adjustments	£144,430

Step 2: allocate profit between the partners

	Total	John	Hook	Feelgood
		50%	30%	20%
Profit	£144,430	£72,215	£43,329	£28,886
Motor	£(8,300)	£(4,000)	£(2,400)	£(1,900)
Cap allces	£(6,630)	£(1,750)	£(1,420)	£(3,460)
Surgery	£(9,500)	£(9,500)	-	-
Net share	£120,000	£ 56,965	£ 39,509	£ 23,526

OTS recommendations

3.18 We can see that some firms would want to exercise control over expense policy, in a similar fashion to that exercised by many employers. Many large partnerships/LLPs follow this route. We do not consider that any proposal to allow partners to claim legitimate expenses from their profit share need change current arrangements where partners need to claim expenses through their firm – if that is the expense policy under the partnership agreement, then no change from the current system need apply to that firm.

3.19 The evidence we have received under responses above shows that partnership profits would be more accurately stated before at least some of those allowable expenses incurred by the partners, and indeed would follow the accounts figures. HMRC have pointed out that such a change could potentially result in one partner showing a loss, with another showing a profit. We accept this is theoretically possible but it seems an unlikely scenario. In any event the loss/profit situation can already occur where salaries or interest on capital are drawn on account

of profits, and statute[1] sets out the adjustments necessary. We consider this procedure would similarly apply if the expense deduction were to result in these exceptional circumstances.

3.20 **The OTS recommendation is to simplify and streamline the computations above, by allowing partners to claim their allowable expenses incurred from their share of the profits, where the partnership agreement is set out on this basis. Such an approach would eliminate the step one from the adjustments in the example above, i.e.**

- **Deduct allowable expenditure and capital allowances incurred at partnership level**
- **Allocate the profit share (before individual adjustments)**
- **Deduct the allowable expenditure and capital allowances incurred by the individual partners.**

3.21 We acknowledge that HMRC consider that such an approach would not be in keeping with the principle that only expenses incurred wholly and exclusively for the purposes of the trade can be relieved against taxable profits. As the trade is the partnership's, HMRC's view is that expenses can only be claimed by the partnership, not the individual partners as they do not carry on the trade. However, it seems to us that ignores the principle that the partnership consists of partners carrying on the business together – it can only be carried on by the partners. The partners take a share of the firm's results to represent the results of their trade. Why should they not be allowed to deduct costs from that share – if that is how they wish to organise themselves? We suspect that we and HMRC will have to agree to differ on this issue but we will continue to recommend the change on the grounds that it would simplify procedures for many partners and their firms. Our continuing work on this issue has produced a wide range of calls for the change to be made.

3.22 Using the same facts as in the example above, when completing the trading pages of the Partnership tax return for 2013/14, the following composite entries would be needed on this basis:

[5] Section 850 ITTOIA2005

Box 3.B: OTS proposal on partners' expenses

Employee costs £24,000 in box 3.51

Premises costs £12,000 in box 3.52

Motor expenses £7,500 in box 3.55

Capital allowances £3,750 in box 3.70

The net taxable profit (box 3.73) returned by the partnership for the 12 months to 31 December 2013 would follow the accounts and would be £144,430. This is allocated as follows:

Step 1: adjust for expenditure incurred by the individual partners – no longer necessary

Step 2: allocate profit between the partners leaving them to claim a deduction for allowable expenses incurred personally, and capital allowances on their allowable expenditure.

	Total	John	Hook	Feelgood
		50%	30%	20%
Profit	£144,430	£72,215	£43,329	£28,886
Motor	£(8,300)	£(4,000)	£(2,400)	£(1,900)
Cap allces	£(6,630)	£(1,750)	£(1,420)	£(3,460)
Surgery	£(9,500)	£(9,500)	-	-
Net share	£120,000	£ 56,965	£ 39,509	£ 23,526

3.23 This is clearly a simplified computational procedure, but additionally such a change would enable the partnership return (and therefore the individual returns) to be finalised sooner, by eliminating the need to wait for each partner to report back (possibly via a different agent) their own expenses and capital allowances incurred.

3.24 **We reiterate that we see this as an option. Whilst we note HMRC's concerns, we do not think they are valid. We accept that this change would mean a small Exchequer cost, but only in terms of legitimate costs that are not currently being relieved.**

4 International issues

4.1 Over the course of our consultation during which we formed the Interim Report, we heard a lot of comments around the international treatment of partnerships. It was particularly felt that the international treatment of partnerships, in comparison with corporations, was administratively disproportionately involved and presented difficulties for UK partners, partnerships and HMRC. The view that partnerships were often something of an after-thought in international business transactions was repeated.

4.2 There were a number of unique 'sundry' difficulties which were presented to us, as well as a few specific difficulties faced by a larger number of partnerships. Our discussions with HMRC reveal the Department is not always aware of these difficulties, possibly because advisers have found legitimate work arounds to solve them, albeit with some extra administration and general inefficiency. We have produced a list of these issues below. In the main this has been presented as a list for HMRC to take forward, though where we have been offered solutions we have noted them.

4.3 A key issue is the US LLC, which the US view as transparent but HMRC treat as a company, so that monies coming out are treated here as a dividend with no credit for the US taxes suffered as a partnership share. This is currently the subject of litigation before the Supreme Court[1].

4.4 We should also record that a number of our respondents paid tribute to HMRC's willingness to be pragmatic in a number of areas. In effect HMRC operate, within their powers, some unofficial practices to simplify administration and save time all round. At the same time, concerns were expressed over these being concessions and vulnerable to tightening/regularising of procedures.

Awareness of the international treatment of partnerships

4.5 Even among some international firms, knowledge of the tax treatment of the UK liabilities of non-resident partners in UK LLPs is low. This means that getting the right result is invariably expensive and difficult, and can result in the entire process containing a degree of commercial uncertainty for partnerships. This is a specialist area and often a necessarily complex one. It means it is difficult to make changes to simplify matters. Below we have listed some points where there are matters of clarity which could be picked up to make the application of the law slightly easier.

Clarity within double taxation treaties

4.6 The majority of fiscal authorities treat partnerships in accordance with the OECD's 1999 review of the application of double taxation agreements to partnerships- i.e. they subscribe to the concept of fiscal transparency.

[1] Anson (Appellant) v The Commissioners for Her Majesty's Revenue and Customs (Respondent). Case ID: UKSC 2013/0068

4.7 This is not universal across all countries- for example, due to their corporate features, a number of territories such as Italy treat LLPs as opaque. China does not have a business entity analogous to a partnership, and hence does not subscribe to this concept.

4.8 This a source of potential confusion, as the position of partnerships is not explicitly documented in many treaties. Even though most countries subscribe to a similar concept it was considered to be helpful for clarity's sake if the position of partnerships and LLPs were documented within the treaty itself.[2]

4.9 A further specific issue is how profits earned in different countries should be allocated between partners resident in the various territories. The difficulty here is that there is inconsistency in how these profits should be taxed across countries. Here is a further example from one contributor which elaborates on this:

Box 4.A: Example of complexity for international partnerships

A partnership has 1 partner in Israel and 9 partners in the UK, each sharing global profits of 5,000 equally (i.e. 500 each). Assuming that the UK operations made 4,900 and Israel 100, then the majority of countries take the view that each partner (irrespective of residence) has made 490 of UK-source profit taxable in the UK and 10 of Israeli profit taxable in Israel. The UK (following this majority view) will therefore tax the Israeli partner on 490. Israel take the opposite view and say that they have primary taxing rights over 100% of the Israeli partner's 500 profit share (without giving DTR credit relief) because he worked the full year in Israel and therefore his 500 must all be profit attributable to his fixed base in Israel.

4.10 Where the majority view is not agreed upon, it is possible that partners will be doubly taxed without relief. In the example above, the Israeli partner would face taxation in Israel on 500 of profit, and in the UK on 490 of profit. It would be helpful if the agreed approach to this kind of profit streaming was also made explicit in the double taxation agreement.

4.11 There is a final, generic point in that the theme of partnerships often appears to be something of an after-thought by the legislative draftsmen. UK tax legislation broadly states that partnerships are to be treated as transparent "unless the contrary intention appears". There have been several instances over the years where debate has arisen as to whether or not there was any contrary intention e.g. for transfer pricing purposes. It would appear to be sensible to attempt to explicitly state within the legislation if there is a contrary intention in order to improve clarity and certainty for both taxpayers and HMRC officers alike and to avoid these sorts of debates.

4.12 **The remedy is clearly that all DTAs should recognise partnerships fully and address the situations we have noted. Equally clearly, we recognise that this is not something the UK can do unilaterally and indeed that it will be a major task to revise all the UK's DTAs to properly cater for partnerships. In practical terms, all we can reasonably recommend is that future DTA renegotiations have a requirement to consider partnerships and the sorts of issues mentioned in our reports.** We note the proposed treaty provision on transparent entities under Base Erosion Profit Shifting (BEPS) Action 2 will help achieve this, stating: 'this report proposes to include in the OECD model tax convention a new provision and detailed commentary that will ensure that income of transparent entities is treated, for the purposes of the convention, in accordance with the principles of the partnership report. This will not only ensure that the benefit of tax treaties

[2] HMRC have confirmed that where specific difficulties are apparent, they will seek to provide clarification in the treaty. Recent treaties with France and Japan, and protocols with Canada and India, are examples.

are granted in appropriate cases, but also that these benefits are not granted where neither contracting state treats, under its domestic law, the income of an entity as the income of one of its residents.'

Clarity of HMRC powers

4.13 HMRC's operational staff reported to us that there was often a lack of awareness around HMRC's powers to recover tax on non-resident partners' profits from the UK partners[3] of the partnership itself. The legislation on profit sharing[4] was also considered to be unclear. In the absence of legislative change, we consider clearer HMRC guidance would assist in encouraging partnerships to expand their business and customer base overseas.

Residence and withholding tax problems

4.14 The most common issue we heard about for international partnerships was one of residency and the impact on withholding tax requirements, usually in the context of cross-border work and consequent taxes. There is a problem for partnerships in securing treaty entitlements to reduced withholding taxes, due to practical difficulties in obtaining certification of the treaty residence which qualifies them for that entitlement.

4.15 The first difficulty concerns the taxation treatment of partnerships and LLPs in other territories. This problem is especially prominent for LLPs; some territories view LLPs as an opaque body corporate, while HMRC will often not certify LLPs as having any residence because they are transparent for UK purposes.

4.16 We were given examples of four main situations:

1. Germany/Sweden/France/Netherlands – fees can be paid gross to a UK LLP without questions asked
2. Poland/Romania/Kazakhstan – a residence certificate is required for fees to be paid gross to a UK LLP
3. Indonesia/Portugal/Bulgaria – require a set form to be stamped before fees can be paid gross to a UK LLP, which HMRC will not stamp
4. Saudi Arabia/Mexico – will automatically withhold tax

4.17 For members of UK LLPs this is no doubt frustrating – the withholding tax is unlikely to be regarded as creditable by HMRC and could fully eliminate the level of profit on those fees paid under deduction.

4.18 In practice, HMRC have in the past granted treaty eligibility either to a UK partnership if all the partners are UK residents, or to the UK-resident partners of a UK partnership[5]. From the comments we have received it may be that this is not being applied consistently - that sometimes HMRC officers have certified a partnership itself as eligible for treaty relief, and some have (as is technically correct) refused to certify that the partnership is resident, instead certifying the eligible partners. In the first instance, it would be helpful if there was more consistent and publicised practice on this issue across the department.

4.19 The second difficulty is an administrative one and occurs where both countries are in agreement that the partnership is transparent, international firms tend to be very large, often

[3] S835E ITA 2007 & s969 CTA 2010, http://www.hmrc.gov.uk/manuals/intmanual/INTM268020.htm#IDANP4RH

[4] S849/850 ITTOIA 2005, s1269/1272 CTA 2009

[5] http://www.hmrc.gov.uk/manuals/intmanual/INTM162110.htm

with hundreds of partners, and there is still a disproportionate administrative burden in obtaining residence certification for every incoming payment. This is compounded by a further practical difficulty, as large partnerships' profit shares are not usually determined until after the year end, so actually establishing the percentages of partnership income can be difficult.

4.20 A number of solutions were suggested for this issue. A few groups noted that as LLPs are bodies corporate, presumably they should be resident somewhere. Why could HMRC not certify that LLPs are UK-resident[6], while noting that the UK tax code deems them to be transparent? We have not explored this issue further here, but would like to note that this would not be a universal panacea, as general UK partnerships and limited partnerships are not bodies corporate, so they would continue to run into similar problems.

4.21 We have heard comment that the current text of the HMRC Certificate of Residence for partnerships could be improved – the HMRC certificate commences by saying that the partnership could not be certified as resident. Even where it subsequently stated that the partners were resident, the message to the foreign tax authority was a negative one.

4.22 One other solution would be to put in place a form of long-term certification for all partners between the UK and other key countries to alleviate the administrative burden.

4.23 We also need to note concerns we have heard that the difficulties noted above on certification may be increased from the Base Erosion Profit Shifting (BEPS) project, given the added emphasis placed on the importance of obtaining detailed documentation certifying treaty residence within the paper on hybrids and treaty responses.

4.24 The work on BEPS could be a catalyst for sorting out better procedures for partnerships.

Tax returns

4.25 If an international partnership has UK partners, in principle all the worldwide partners should file UK tax returns. For a US partnership with (say) 100 US partners and two UK ones, this implies a considerable administrative burden to file those 100 returns, probably for minimal extra tax.

4.26 We have heard that HMRC frequently will take a pragmatic approach. As an example HMRC may accept composite filing by way of one UK return for all the 100 US partners in the above example. We noted that USA, Germany and France will not accept composite filing. The UK approach is welcome and seen as a useful competitive advantage for the UK. Against this, one respondent suggested HMRC's stance is hardening and they fear this pragmatic approach may be withdrawn, even though it clearly saves HMRC a good deal of work as well.

4.27 Problems arise if there is other non de-minimis income, or if a partner changes firms – inevitably that means full formal returns are needed.

4.28 Currently the 'composite returns' process operates by agreement. T**he OTS recommends that the position be formalised to provide certainty. We think an HMRC Statement of Practice could cover this, rather than primary legislation**.

4.29 Composite filing would alleviate another problem that we have been told about – we understand HMRC practice is now to require all non-resident partners to have Unique Taxpayer References (UTRs), even where no UK tax liability arises. There is guidance on procedures to

[6] We should note that there are DTAs where HMRC will provide a certificate of residence in the name of the partnership, such as the UK/Argentina DTA

obtain a UTR in the Self Assessment Manual[7], and the **OTS recommend that this is clearly linked from the Partnership Manual.**[8]

Partnerships and short-term business visitors

4.30 Partnerships with highly mobile international staff (which is common in the professional services sector where partnerships are the preferred business format) have a particular issue with short-term business visitors. Such visitors are usually exempt from income tax in the UK on the condition that they are not paid by a UK employer. There is a technical argument that treaty relief under Article 15 (income from employment) is not available to employees of a partnership as they could be argued not to have a non-resident employer. This could mean it may be argued that a short-term secondee from another country does not qualify for treaty protection even if their remuneration is borne by the non-UK branch of the same company. We understand that in practice, HMRC do sometimes accept treaty relief is available.

4.31 This seems commercially unreasonable - that the choice of business structure could affect the amount of income tax paid by an employee. In practice, HMRC has treated the employer as a non-UK one if the individual is under the control and instruction of non-UK resident partners. **If there is no policy reason for keeping employees of partnerships from accessing this exemption, it would be useful to formalise their access to this exemption.**[9]

Overlap relief

4.32 In our Interim Report we noted the difficulties faced by both partnerships and other unincorporated businesses with overlap relief. At the time we recommended a comprehensive review into both basis periods and overlap relief, and we welcome HMRC's positive response to our recommendation.

4.33 We have received some more comments on overlap relief from international partnerships. The comments we received strongly suggest that there should be consideration to phasing out overlap relief and replacing it with something that better interacts with double taxation agreements.

4.34 We should point out that no other country in the world contains within its tax system a concept similar to overlap relief, or even a concept similar to the double taxation of profits in opening years. Overseas tax authorities are often confused by this when they are seeking to give DTR credit under their own countries' rules to their residents. Similar problems are likely to apply in relation to UK resident members of international partnerships and partners. Often there is no later profit to absorb the overlap relief due.

4.35 In returning to this issue we are well aware that reforming the opening year rules for a business is an issue for sole traders as well as partnerships. However, many of the international problems discussed in this section are inevitably only applicable to partnerships.

4.36 The examples below have been suggested to us as cases in which overlap relief has been the direct cause of double taxation.

[7] HMRC Self-Assessment Manual SAM 100137

[8] HMRC have told us that since the OTS interim report, they have introduced a simplified process for partnerships with non-UK resident partners.

[9] HMRC also told us that there is no general policy of denying this exemption to employees of partnerships. Eligibility will depend on whether the employing partnership is resident outside the UK based on the residence status of the partners.

Box 4.B: Examples of complexity caused by interaction of overlap relief with double taxation relief

Example 1:

Spain is an example of an overseas country which itself operates a double tax credit system. The Spanish tax authorities would be faced with two sets of UK income tax paid on the same UK profits in the opening years. Even if they were willing to give the credit on both occasions, the effective doubling of the UK tax would be likely to exceed the Spanish tax payable on the figure of profits, and therefore limit the amount of relief available.

Conversely, when the partner retires from or leaves the partnership, overlap relief will reduce the UK income tax payable in the final years, and therefore the double tax credit available will be considerably lower than the Spanish tax due.

The overall picture is that the overseas partner is prevented from obtaining full tax credit, in the home country, for the total UK income tax suffered. We understand, however, that the US and Germany do not restrict relief by reference to the double assessment of profits.

Example 2:

Increased globalisation creates a common problem on UK overlap relief. For a new partner, the amount of overlap would be set at a time when the profit share was largely or wholly UK based. On retirement, the firm is likely to have expanded overseas operations, and the UK profit share may have reduced. Take an example of consistent profit share levels of £120,000 comprising 100% UK profit in the first year but falling to 50% in the year of retirement. Say £110,000 of profits would have been subject to double taxation in the first year, overlap relief of £110,000 could be claimed against world-wide profits on retirement, but given the profit share is only 50% UK based by that time, overlap relief would eliminate the UK profit of £60,000 and the remaining £50,000 would be set against non-UK profits, substantially restricting the amount of credit due against overseas tax paid on the overseas profits.

Advisers may work around this and ensure that sufficient UK profits are available in the final years, adding to compliance costs. Larger firms may have the facility to engineer a 'retirement' of a partner when profits are available to absorb overlap relief, followed by their re-joining on a different basis.

Example 3:

A non-UK resident partner may have had a share of UK source profits in their opening years on joining or forming the partnership, but by the time of retirement, no longer receives UK source profits (for example home country operations via a sister partnership fully cover the remuneration entitlement). There would then be no profits assessable to utilise the overlap relief.

In such a situation, it would be preferable for HMRC to allow the partner to elect to take overlap relief early, rather than the complication (for all parties including HMRC) of ensuring the partner receives UK based profit in the year of retirement.

Other differences in treatment between partnerships and corporations

Annuities

4.37 Many partnerships pay annuities to former partners. Annuity income is rarely covered in tax treaties and disagreement of treatment and confusion can arise as a result. It would be helpful if partnership annuity income was explicitly covered in tax treaties where possible.

Foreign exchange

4.38 We have heard from a few sources that there is a good deal of uncertainty when dealing with the taxation of foreign exchange for partnerships. This is due to the lack of new legislation dealing with this aspect of taxation for the purposes of income tax rules; the corporation tax legislation set out the taxation of Forex some years ago. As partnerships and sole traders are (in comparison to corporations) not common users of these rules, there has been a lack of case law in place to clarify this uncertainty.

4.39 It would be helpful if HMRC would clearly publish their position on the Forex rules as they apply to modern-day transactions and scenarios e.g. such as how the revenue versus capital definition is applied in the context of different types of Forex gain or loss arising.

4.40 The greatest simplification would be to align completely the income tax rules with the corporation tax ones. This would be logical: the same rules would then apply to all businesses (apart from perhaps sole traders who are unlikely to find problems in this area). We accept that this would be a policy change which we have not reviewed in further detail here.

4.41 **We recommend that the alignment of the tax rules in this area is pursued but if it is considered that such changes would be too difficult to effect, then at a minimum HMRC should publish clear guidance on the area.**

Remittance basis

4.42 For partnerships carrying on business partly in the UK, but managed and controlled outside the UK, section 857 Income Tax Trading and Other Income Act (ITTOIA) 2005 allows a non-domiciled partner to claim the remittance basis on the non-UK component of their profit share.

4.43 It is therefore necessary to determine what part of a remittance to the UK relates to UK profits. Although we understand HMRC practice was to allow the remittance of a non-domiciled partner to come initially from the UK profit share, new section 809Q Income Tax Act (ITA) 2007 sets out the priority from mixed funds, and is silent on this issue, leaving the UK profit share to come under 'other' income or capital, which means remittances will be treated as coming first from non-UK profits.

4.44 We were given the example of a UK resident but non UK domiciled partner who is allocated £100 overseas profit which they remit back to the UK from a mixed account. The result can be an assessment of £200 (the amount arising and the amount remitted) which is unfair and surely not intended. Had this been an employee, the priority rules would mean the first amount remitted is the £100 income.

4.45 Advisers can work around this for partnerships by ensuring separate accounts are maintained. The OTS believes this should not be necessary and **that the omission from the legislation of partners should now be corrected.**

VAT

4.46 In the context of Indirect Tax, it can be confusing for partnerships to determine where VAT is payable on services that are supplied between different EU Member States. This is because there is a VAT principle, commonly known as force of attraction, which has been adopted by a number of EU Member States. Where the principle applies, VAT can be due from a branch located in the same territory as the partnership's customer even if that establishment does not play a significant role in supplying the services concerned. In the context of international partnerships that operate across the EU this can create VAT reporting issues where a UK establishment of that partnership supplies services to a customer in another Member State where it also has a branch. For the principle to apply, it can only take an insignificant amount of intervention by that branch for the tax burden of the entire supply to become its responsibility. The legislation as it is set out in EC Directive 2006/112 article 192a is, in itself, clear. However the implementation of this article across the EU is inconsistent (for instance the UK has never adopted this principle). This can make Indirect Tax compliance administratively burdensome for partnerships operating in multiple jurisdictions across Europe. The issue can be worked around by invoicing appropriately, but longer term the EU member states need to agree a consistent approach to the directive.

The double tax treaty passport scheme

4.47 The UK has operated the Double Tax Treaty Passport scheme (DTTP) since September 2010. It was revised in April 2013 to provide a swifter and more efficient method of providing double tax treaty relief on UK loan interest payments to non-UK residents. It is administered by the HMRC DT Treaty Team.

4.48 However, the DTTP is only available to UK companies who borrow from overseas companies. For example, if a UK limited partnership (LP) was established to act as a Joint Venture vehicle to hold a UK property, with a UK general partnership (GP) and two UK corporate partners, any borrowing by the UK LP from a non-UK lender would need to go through the individual territory's double tax treaty relief forms prior to the payment of any interest, to access the benefit of the Treaty rate of income tax. The normal Treaty clearance can be a time consuming and inefficient process for both HMRC and the borrower.

4.49 We were given examples of borrowing externally from two US lenders (both of whom had DTTP reference numbers) where it was not possible to access the DTTP Scheme to give certainty quickly that there would be no UK witholding tax payable, as the borrowing entity was not a UK corporate body. Instead, they had to use the traditional clearance process with the lenders completing the relevant forms for processing by the IRS and HMRC, which was a time consuming process.

4.50 There appears to be no particular reason for limiting the DTTP Scheme to corporate borrowers where the UK tax risk is with the identity of the lender rather than that of the borrower. This distinction appears to simply derive from the terms on which the scheme was written, and **we raise this issue for HMRC to review**.

5 Group structures with LLP members

5.1 HMRC already provide some guidance on Stamp Duty and Stamp Duty Land Tax (SDLT) where partnerships are involved in group structures[1] but there is no material on group structures in relation to Corporation Tax, Capital Gains Tax or Inheritance Tax.

Corporation tax – group relief

5.2 From feedback we have received, clarification is needed in the following areas:

- Advisers have told us they find the legislation unclear in this area. Section 1273 Corporation Tax Act (CTA) 2009 says that for all purposes (except as otherwise provided) references to a company do not include an LLP, while section 188 CTA 2010 specifies that for Part 5 (group relief) a company means any body corporate. It is unclear whether this means an LLP can head the group, with no facility to look through, and unsurprisingly, HMRC treatment is not uniform in deciding whether group relief may be claimed.
- Is there then a difference between LLPs and general partnerships in applying the look through test for group relief purposes? Section 1258 CTA 2009 says that unless otherwise indicated, a firm is not to be regarded as an entity separate from the members, which appears to permit 'look through' when applying group relief.
- The CGT legislation on groups is clear however, with section 170(9)(b) TCGA 1992 specifically excluding an LLP from being a company for CG group purposes.

5.3 **The OTS recommend clear guidance be included in the Partnership Manual to address these areas,** which we understand HMRC have agreed to.

Inheritance tax

5.4 The July Update Report set out a request for HMRC to review the area of Business Property Relief[2] (BPR) being available where an LLP holds trading companies as well as the Entrepreneurs' Relief treatment noted below. Shares in a holding company of a predominantly trading group qualify for BPR under section 105(4) Inheritance Tax Act (IHTA) 1984. However, no such provision applies where an LLP is the holding vehicle for the trading group. The circumstances of anomalous results of an LLP heading the group instead of a company may apply in both cases and it would be unfair to only look at one of the reliefs applying. The OTS acknowledge that legislation may be necessary to correct the anomaly and allow the business property relief.

Capital gains tax

5.5 HMRC's response to the Interim Report includes an undertaking to clarify within the Partnership Manual whether Entrepreneurs' Relief applies in the situation of an LLP heading a

[1] www.hmrc.gov.uk/so/group-rel-sdlt-sd.htm

[2] Paragraph 2.11

trading group of companies. Professional bodies have informed us there are currently two schools of thought on whether relief is due, and we welcome HMRC's review.

6 Capital gains tax - HMRC Statement of Practice D12

6.1 HMRC Statement of Practice D12 (SPD12) was originally issued by the Commissioners of Inland Revenue on 17 January 1975 following discussions with representative bodies, and sets out a number of points of general practice in respect of partnerships, based on the brief underlying legislation at section 59 Taxation of Chargeable Gains Act (TCGA)1992. Following the enactment of the Limited Liability Partnership (LLP) Act 2000, SPD12 was extended to LLPs under section 59A (which makes certain deeming provisions so that section 59 can apply to LLPs and their members in the same way as it applies to general partnerships and partners).

6.2 The OTS Interim Report noted that commentators had observed it cannot be right for a major area of CGT to be governed almost entirely by a statement of practice.

6.3 The Interim Report set out three options regarding the practice:

1. Introduce new legislation reflecting SPD12 as far as is currently relevant
2. Leave SPD12 alone, given that the majority of partnerships are small, with few capital assets, which therefore encounter few issues here
3. Accept that the principle of SPD12 still holds good, but rewrite the statement so that it reflects today's business environment and changes in business ownership and operations since it was written.

6.4 When we explored further, it became clear there was no appetite generally for legislating the statement, which would prove to be both complex and lengthy. The feedback we received was that SPD12 had stood the test of time and was generally understood. There were issues, however, around changes in business practices since the 1970s, some of the references were out of date, and the style of writing would benefit from a more modern presentation.

6.5 The Interim Report therefore concluded that the best way forward was a hybrid of options 2 and 3, keeping the SPD12 in place but updating it to accommodate current practices and language.

6.6 We have met with HMRC, who share our view that this is the favoured option. It is considered that because SPD12 is entirely consistent with the legislation, there is no risk of HMRC offering concessionary treatment as considered in the R v CIR ex parte Wilkinson[1] case. If a partnership or LLP were in a dispute over an assessment or a decision, then an appeal to the Tax Tribunal is still considered to be appropriate, and would be based on the underlying legislation.

6.7 We have advised HMRC that updating of the statement should take on board the following comments that have been made to us:

- There was a previous widespread misunderstanding of whether paragraph 4 (Change in Partnership Sharing Ratios) applied where a partner contributed an asset

[1] [2005] UKHL 30

to the partnership by means of a capital contribution. Revenue & Customs Brief 03/08[2] acknowledged that HMRC officers may have erroneously applied paragraph 4 more widely than was justified where an asset was contributed to a partnership, contributing to the misunderstanding. The correct treatment was set out in the Brief, but no change to SPD12 was made. Although the change may have fully bedded in with the majority of the tax profession, we feel that opportunity should be taken of the update in order to cover this point.

- We understand the wish HMRC have to keep SPD12 compact with clear principles, with examples being available in the Capital Gains manual (which has been updated fairly recently). The update should include links to appropriate manual guidance and examples, and in turn, the manuals to include a link to the helpsheet 288.
- The term 'asset surpluses' in paragraph 4 requires updating, and in general the large paragraphs of text need breaking down into a more modern draft.
- When SPD12 was originally drafted, the majority of partnerships were professional partnerships, and money rarely changed hands on entering/leaving. The practice is more widespread now, and we recommend paragraph 6 of the statement be revised to clarify the position.
- The statement is currently silent on whether hold-over relief may be claimed when a charge to CGT arises, and the OTS would welcome a reference within the updated statement.
- The current statement includes references to April 1965 and 19 March 1968, and the OTS wonder whether these remain relevant.
- Paragraph 12 of the current statement is out of date, with references to goodwill and taper relief. The issue of entrepreneurs' relief is looked at further below.

6.8 **HMRC have agreed to produce an updated version of SPD12 in line with our recommendations. This will need to be published for comment before it is formally adopted**.

6.9 We have heard the difference in wording between section 59 TCGA 1992 and section 59A has caused some confusion over the exact sense in which partners 'hold' partnership assets. We have put these issues to HMRC, and given that the updated statement will be light touch, agree that the correct place to address these will be within the consolidated Partnership Manual. The subject of education is covered in more detail in chapter 2 in this report, but it has been made clear to us that many small partnerships and their advisers are not aware of the existence of SPD12. These businesses will have few capital assets and are unlikely to encounter too many issues here, but it does not seem right that they are not aware of how goodwill, for example, is treated on changes in partner members, or changes in partnership sharing ratios. **We feel that the timing of the updated SP D12 could be used by both HMRC and the tax profession to launch seminars and releases in order to raise awareness of the statement and its relevance.**

Entrepreneurs' relief

6.10 Eligibility for Entrepreneurs' Relief for shares in trading companies held by an LLP was raised in our previous papers, and HMRC have undertaken to include clarification within the consolidated partnership manual.

[2] http://webarchive.nationalarchives.gov.uk/20090606014021/http://hmrc.gov.uk/briefs/cgt/brief0308.htm

6.11 The OTS has been advised that the professional bodies raised a number of technical questions to HMRC in 2011, but a publicised full response has not been made. Whilst small general partnerships are unlikely to encounter these issues, there is currently uncertainty on how the legislation applies for LLPs and more complex partnerships, and **the OTS calls for full clarification on these points within the Partnership Manual**. We understand that HMRC acknowledge the guidance would benefit from updating, and have this in hand. The questions raised are included in Annex B of this report, without editing by the OTS.

7 Gift aid and partnerships

Background

7.1 The UK tax system has encouraged charitable giving for many years. The gift aid scheme was originally introduced for individuals in the 1990 Finance Act, but relief was previously available under charitable Deeds of Covenant.

7.2 The current legislation for individuals is at sections 413 to 430 Income Tax Act (ITA) 2007. The donation is treated as being made net of deduction of tax at the basic rate. Provided qualifying conditions are met, the charity may reclaim this tax from HMRC. Higher rate taxpayers may claim further relief through their self-assessment return.

7.3 Income tax relief (though not by deduction at source) extends to gifts of shares, securities and real property to charities (sections 431 to 446 ITA 2007).

7.4 Companies have been able to claim relief for qualifying donations to charity by deducting the donation in arriving at profits chargeable to corporation tax. The current legislation is at sections 189 to 202 Corporation Tax Act (CTA) 2010. The relief for companies is also known as gift aid, but unlike the gift aid scheme for individuals, the payments are made gross and therefore no repayments are made to the charity. Corporation tax relief for certain disposals of investments to charities is given at sections 203 to 217 CTA 2010.

The issue for partnerships and Limited Liability Partnerships (LLPs)

7.5 Our Interim Report identified an issue raised by our stakeholders that, unlike individuals or companies in business, there appeared to be no provision for partnerships or LLPs to claim relief for gift aid contributions to charity. Instead, any donation must be allocated to the partners and claimed/treated as a donation by each individual with each person required to complete relevant forms, potentially signing appropriately in some cases. For a small partnership this may not be a particular problem, although it is cumbersome. For a large firm it can be a considerable administrative burden[1].

7.6 We were told that many of these firms tend to take decisions around donations collectively, sometimes in line with general firm plans. In the absence of a direct relief, and to avoid the necessity of doing a full allocation, some firms have even set up their own charities in order to access relief.

7.7 Many firms have said to us that it would be a useful simplification to have a simpler procedure to enable partnerships to access relief. This is not just a point raised by the largest firms; the point has also been raised by advisers to farming partnerships to give one example. There seem to be two routes to consider:

1. Rather than require each partner to complete gift aid forms, allow the representative partner to complete an appropriate declaration on behalf of the firm.

[1] We will refer simply to partnerships in the rest of this chapter rather than referring to both partnerships and LLPs but the same considerations will apply to LLPs as partnerships.

2 Allow the partnership to claim a deduction in arriving at profits, which would effectively give relief in a similar way to that available to a company.

HMRC guidance

7.8 The current online guidance notes within the charities section of the HMRC website states[2]:

Box 7.A: HMRC guidance on gift aid and partnerships

In England, Wales and Northern Ireland a business partnership does not have a legal personality. So a donation by a partnership consisting of individuals is treated as made by the underlying partners. One partner may make a Gift Aid declaration on behalf of all the partners, provided he or she has the power to do so under the terms of the partnership agreement or some other instrument given under seal. In that case it will be sufficient for the declaration to show the name and address of the partnership. Otherwise, it will be necessary for each individual partner to make their own Gift Aid declaration. They may do so on the same declaration form, provided it lists all their names and home addresses.

Limited Liability Partnerships, and partnerships in Scotland, have a legal personality. So, in all cases, one of the partners may make a Gift Aid declaration on behalf of the partnership, showing the name and address of the partnership.

The partners should enter their share of the donation on their own Self Assessment return. How the donation is apportioned between the partners is a matter for them to decide. For example:

- in equal shares
- in accordance with their share of the partnership profits set out in the partnership agreement
- in whatever split the partners agree

7.9 We have met with HMRC and expressed our view that this guidance appears to provide a common sense solution to the issue. However, HMRC do not consider their own guidance correctly sets out the appropriate declaration required under the Regulations[3], and consider they require in particular a list of the partners' names, their addresses and details of the shares of the donation (although signatures are not required). In other words, HMRC have told us they cannot trace the legal advice underpinning their current guidance, and wish to check this with their solicitor's office.

7.10 The additional information is to enable HMRC to check that a sufficient amount of tax has been paid by each donor. This parallels the normal requirements for individual gift aid donations, to guard against tax being repaid to a charity that has not been paid by the donor. However, although we can see the theoretical possibility of such a problem with partnership donations, we do question whether (particularly for large firms) this is sufficient justification for imposing the administrative burdens that result.

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[2] http://www.hmrc.gov.uk/charities/guidance-notes/chapter3/sectionb.htm

[3] SI 2000/2074 paragraph 4

An alternative relief

7.11 We set out above the gift aid relief available to companies. To prevent a double deduction for the same donation, a deduction from profits higher up in the computation is prevented by section 1301B Corporation Tax Act 2009.

7.12 However, in the absence of a comparable gift aid deduction, no such provision prevents a deduction from trading profits for a partnership or an LLP (in respect of individual members). Provided the donation to charity is made wholly and exclusively for the purpose of the business, then a deduction in arriving at trading profits would be due.

7.13 There is of course a difficulty in establishing that a donation is 'wholly and exclusively' for the business. The usual practice has been to accept that small donations to local bodies would qualify. This is reflected in HMRC guidance[4].

7.14 Again, we have discussed the guidance with HMRC, who concede that it is misleading to indicate that a donation to a voluntary body which does not have a local connection to the business may not be incurred wholly and exclusively. The understandable concern revolves around possible donations where there is a personal connection with the donor, or a lack of publicity surrounding it. This is more likely to occur with smaller partnerships, with a partner (or all the partners) having a personal interest in making the donation.

OTS conclusions and recommendations

7.15 As a first step, any HMRC guidance needs to be amended to reflect the correct legal position for both relief as a trading profits deduction and access to personal gift aid, assuming HMRC are not prepared to operate it as a concession (though in any event it would be better to have the position formalised). If any changes are made as a result of the OTS's recommendations, the guidance material will naturally need to be updated accordingly and proper publicity given.

7.16 The OTS believes that procedures around donations by partnerships need to be simplified. **Our recommendation is that there should be two alternative routes available to partnerships:**

1. **The firm may make a donation and the relevant gift aid declaration is made by the representative partner. The donation would be treated as made under gift aid by the individual partners with the charity entitled to reclaim the basic rate income tax.**
2. **The firm may simply take a deduction for the donation in its computation of trading profits. In this case it would be treated as a gross donation with no eligibility for the charity to reclaim basic rate tax, in parallel to the gift aid system for companies.**

7.17 Under the first route, a further Statutory Instrument would be necessary to remove the administrative burden of listing all partners' names and addresses as described above, and enabling the representative partner to make the declaration, in line with HMRC's own current guidance.

7.18 We accept that the establishment of the second route would need legislation. Although there is effectively permission for this route to be used already, we think it would be far preferable for it to be established under the law in order to bypass the wholly and exclusively

[4] BIM45072

rule, rather than for it to depend on an HMRC administrative easement. The model would be to parallel the existing legislation and rules for corporation tax.

7.19 There would need to be an override that neither of these routes can be used if there is a personal benefit for any of the partners with the donation. In such cases, the donation would have to be apportioned to the partners with each claiming relief under basic self-assessment rules.

7.20 We have considered whether the routes would only be available to certain types of businesses. For example:

- the 'deduction route' might be for LLPs and firms above a certain size
- firms below a certain size might have to give the full details of the partners but above a certain size may use the representative partner route

7.21 There is the risk that either of these routes could be seen as discriminatory but it might be something to explore during consultation.

7.22 The fact that there is a choice may be of concern to HMRC but:

- We do not believe there is any risk of abuse that does not already exist
- We do not believe that there is a risk of confusion: the default position is that the current system of allocation to individual partners will be used; partnerships would have to opt to use the first or second new routes.

7.23 The OTS would like the new Partnership Manual to advertise the trading profits deduction for donations to charity, and link to revised guidance. It should make clear that this constitutes a gross contribution, and the partners, rather than the charity, will benefit from the income tax relief due. This makes this form of relief similar in nature to that of gift aid by companies.

7.24 We believe that the changes we have recommended are fully in line with the basic philosophy of gift aid – to encourage donations to charities. Our work has also established that they are to all intents and purposes in line with the way the rules are being applied at present, although we accept HMRC's view that this is not strictly in accordance with the legislation.

Monetary effect of the donations routes

7.25 The OTS is suggesting that two routes are available for donations. If the aim is to put £100 into the hands of the charity:

1. The traditional gift aid route means the partners will give £80, the charity reclaim £20; the donation would be allocated to the various partners who then claim higher rate relief. Assuming the partners are all 40% taxpayers, the net cost to them would be £60.
2. The deduction route would simply mean the partnership gives a donation of £100 to the charity. There is no entitlement for the charity to reclaim any further tax. As for the partnership, the donation is treated as an expense in arriving at the profits for allocation to the partners. Thus they would get the effective 40% relief and thus bear the net cost of £60.

7.26 It will be observed that the results are the same with the second route meaning simpler procedures and less administration, even before the burden of collecting all the partners' names, addresses and possibly signatures is taken into account.

8 Other issues

Double reporting

8.1 The OTS raised the aim of eliminating double reporting of income figures on the partnership return and the individual's return pages. Our proposal was that the simplest route was to remove (or make optional) the partnership return. We reported in the Update Report that we disagreed with the HMRC assertion that our original recommendation would lead to 'duplication of effort and add to the administration burden.' Our recommendation was geared to lead to precisely the opposite impact.

8.2 However, we are content with the HMRC response of achieving this aim by using the information from the partnership return more fully and obviating the need for partners to report as much on their supplementary pages.

8.3 This will require a digital mechanism, such as enabling HMRC to include a way for the partnership to log each of the partners' names, UTRs, and percentage share of the profits online. The information could then be used to pre-fill all of the partners' separate returns. Each partner would still be required to confirm that the profit share on the partnership return accurately reflects their actual profit share.

8.4 For partners with very simple affairs, this could possibly even remove the need for them to file entirely - they would simply have to log on and acknowledge that the figure on the partnership return accurately reflects reality. One clear advantage this gives over the OTS recommendation is that it could be rolled out to all partnerships, even large ones - in which case it could remove the difficulties some large partnerships face with page 7 of the return[1].

8.5 If the above work were to ultimately result in removal of the supplementary partnership pages, with reporting of the partnership share shown on the self-employment pages, this would be consistent with our proposals in chapter 3 on enabling individual partners to claim allowable expenses incurred personally on their own return and the reporting entries necessary.

VAT reporting requirements

8.6 The OTS notes the HMRC response to our Interim Report proposal to take advantage of digital procedures to finesse the cumbersome reporting requirement of all partners needing to sign VAT2, and is disappointed that little progress is being made here. In view of the burden this requirement is causing, we urge that this matter be given increased priority.

The Annual Investment Allowance and mixed member partnerships

8.7 The OTS is disappointed that a change in legislation to enable these structures to access the relief was not included in the 2014 Autumn Statement. We reiterate our belief that a change is needed, for the reasons we set out in our Interim report; stakeholders have continued to call for such a change in our recent series of meetings.

[1] See 5.12 of the partnerships interim report for a full explanation

Simplifying basis periods for trading income and other income

8.8 Again, the OTS is disappointed that simplification measures on these areas were not included in the 2014 Autumn Statement. In view of the issues raised in the international chapter of this report, in addition to those raised in the Interim Report, we continue to recommend this area be addressed.

A Draft deed of partnership

A.1 A Deed of Partnership, otherwise known as a Partnership Agreement, sets out the precise rights and responsibilities for the partners, in a legally binding agreement.

A.2 Whilst it is not necessary to have such a deed in order to set up a partnership, it is clearly preferable in order to prevent misunderstandings and disputes. In the absence of an agreement, the provisions of the Partnership Act 1890 will apply, which may not suit the partnership in question.

A.3 For a small trading partnership, the following areas should be included within the Partnership Agreement:

- The partnership information: name, address, business type or purpose, start date, and end date if for a fixed term
- For each partner, include their name, address, whether an individual or legal entity such as a company, description and value of their capital contributed to the partnership
- What is the voting requirement to admit a new partner, e.g. majority or unanimous
- How will profits and losses of the business be distributed, e.g. in equal shares, by a fixed percentage, or in proportion to the capital contributions
- Partners' voting rights, e.g. equally, in proportion to profit/loss share, in proportion to capital contributed
- Accounting year end date, accounting policy, i.e. GAAP or cash basis where conditions satisfied
- Name of any managing partner, and the nominated partner for tax return purposes
- Percentage vote required to make binding financial/business decisions and partnership agreement changes
- Mediation and arbitration policies where disputes arise under the agreement
- Notice period for withdrawal of a partner, and period after departure that partner cannot compete with the partnership
- If a partner leaves, whether the partnership will continue or automatically dissolve
- Vote required to dissolve the partnership
- On dissolution, in what proportion will the capital assets of the partnership be distributed, e.g. in proportion to the profit/loss share, in proportion to capital contribution

The above list is intended for small trading partnerships – larger and more complex firms are advised to seek legal advice.

B Questions raised by professional bodies to HMRC on entrepreneurs' relief

As explained in paragraph 6.11, we are reproducing here the relevant sections of a paper submitted to HMRC by a groups of professional bodies in 2011. As far as we are aware, the issues raised in this paper still need to be properly addressed.

E1 – Fractional partnership shares

Sole trader can claim ER on cessation of trade (not necessary to sell the business)

It is not necessary for a sole trader or a partnership to actually sell the business in order to be able to claim ER. A sole trader (such as say an accountant overwhelmed by the 31 January rush) could cease trading, without selling the business, and ER could be claimed on a subsequent chargeable disposal of the freehold business premises.

If a partner retires in similar circumstances, the business continues but the partner makes his actual disposal sometime later. In the meantime his share of the property, goodwill etc sits in a loan account. Does this come under the example in 3.4 of your guidance on the basis that the partner is an individual for this purpose?

E2 – Application of section 169L(1) TCGA 1992 in a Partnership Context

We would appreciate clarification of how HMRC would apply s169L where a partnership holds shares in a trading company, the individual partners are officers of that company and the economic interest of each partner, through the partnership, satisfies the 5% threshold within the meaning of s169S(3).

To use a simple example, a two person partnership with equal profit share and capital entitlement holds 10% of the share capital of a trading company and the partners are both officers of the company.

Technical Tax Analysis

S169L(1) seems to anticipate that a disposal in these circumstances could be a qualifying disposal for purposes of ER in that a disposal of shares (which would be a qualifying disposal in its own right were the shares held directly) does not have to be a disposal of all or part of the business of the partnership.

Does HMRC agree with this analysis of s169L(1) is it accepted that the economic interest of the partners in this situation satisfies the personal holding company requirements of s169S(3), particularly with regard to the wording in s169S(4)?

Alternatively, does HMRC consider that each partner has a 50% interest in 10% of the shares such that it cannot be said that they have a qualifying 5% interest (i.e. with such an analysis no ER would obviously be due)?

Question E3a

Can HMRC confirm that, where the other conditions are met, an individual member can claim ER on the disposal of shares in a trading company where the shares are held through an LLP (whether a trading LLP or, more likely, an investment LLP) of which he (or she) is a member and that LLP owns shares in a number of different trading companies.

Question E3b

A UK trading LLP that owns all the shares in a UK trading company is wound up and the shares in the trading company are distributed to the members. For the purposes of satisfying the 12-month holding period for entrepreneurs' relief on a subsequent sale of the shares, will the members be able to aggregate the period of indirect ownership of the shares through the LLP with the period of direct ownership?

We believe that the answer depends on the nature of the winding up and would be grateful if HMRC could confirm that they agree with our analysis.

Analysis

LLP "tax transparency"

Section 59A(1) of TCGA 1992 states, among other things, that where an LLP carries on a trade or business with a view to profit, assets "held" by the LLP are treated, for the purposes of tax in respect of chargeable gains, as "held" by its members as partners and any dealings by the LLP are treated for those purposes as dealing by its members in partnership (and not by the LLP as such).

Section 59A(1) of TCGA 1992 appears to impute the LLP's holding of the company's shares to the members of the LLP. It is, therefore, arguable that the period during which the LLP holds the company shares as an LLP asset can count towards the one-year period required by section 169I(6) of TCGA 1992.

Section 59A(3)(b) of TCGA 1992 provides that section 59A(1) continues to apply in relation to an LLP which no longer carries on any trade or business with a view to profit during a period of winding up following a permanent cessation ("informal" winding up) provided that the winding up is not connected to tax avoidance and the winding up period is not unreasonably prolonged. This is, however, subject to section 59A(4) of TCGA 1992 under which, on the appointment of a liquidator or the making of a winding up order by the court ("formal" winding up), section 59A(1) ceases to apply.

Informal winding up: LLP share holding continuous with member share holding

If the winding up (resulting in the distribution of LLP assets to its members) is an "informal" one within section 59A(3) and there is no tax avoidance motive and no unreasonable prolonging of the winding up period, the LLP should remain "transparent" during the informal winding up.

It is then arguable that members of the LLP have an unbroken "holding" of shares in the company for the purpose of section 169S(3) of TCGA 1992 that:

- Starts when the LLP acquires the shares (by virtue of section 59A(1) of TCGA 1992).
- Continues during the LLP's winding up (again, by virtue of section 59A(1) of TCGA 1992).
- Continues after the winding up, when the (now former) members of the LLP hold the shares directly.

- Ends when the members of the LLP dispose of their shares.

Formal winding up: LLP share holding stops being treated as member share holding

However, if the winding up is a "formal" one within section 59A(4) of TCGA 1992, it is arguable that, as section 59A(1) of TCGA 1992 ceases to apply, the members of the LLP cease to "hold" shares in the company for the purpose of section 169S(3) of TCGA 1992.

Therefore, when the members of the LLP receive the shares, they will have to wait for at least another year before they dispose of the shares to satisfy the requirement that the company has been the "personal company" of the (now former) members throughout the period of one year ending with the date of disposal of the shares (section 169I(6), TCGA 1992).

Question E4

How does HMRC determine the 'year' a qualifying asset is held? TCGA 1992 s169I states that the period of ownership must be "1 year ending with the date of disposal" to qualify.

This query is easier to follow by way of example. Mr A is a partner and was admitted to the Partnership on 1 October 2008, so 30 September 2009 was his 365th day as a partner, being the same day the qualifying asset was disposed of.

Does this constitute a year? There is an argument that the year will be met only if the asset was sold on the anniversary, i.e. 1 October 2009, however, it could be said that the better argument is that the sale on 30 September 2009 is at the end of a year's ownership such that the one year qualifying period has been met.

F2 – The position of a corporate partner of a trading limited liability partnership

HMRC are asked to confirm whether a company, the sole activity of which is being a partner in a trading LLP, is to be treated as being a trading company and hence a disposal of its shares will qualify for ER provided all other conditions are met

Analysis

CTA 2009 s.1273(1) confirms this as follows:

"*For corporation tax purposes, if a limited liability partnership carries on a trade or business with a view to a profit-*

All the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),

Anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and

The property of the limited liability partnership is treated as held by the members as partnership property.

References in this subsection to the activities of the limited liability partnership are to anything that it does, whether or not in the course of carrying on a trade or business with a view to a profit.

Consequently, the LLPs trading activities are treated as if they are carried on by the corporate member.

F7 – Shareholdings: Partnerships – definition of 'person':

Many private equity (PE) arrangements are operated as a limited partnership (LP) with a corporate general partner (GP).Where the PE holds shares, does it count at one person (either the LP itself, of the GP company that controls it) or does the interest have to be allocated between the LP members? There is no definition of person in TCGA 1992, but it is in a few other places as: any body politic, corporate or collegiate, and any company, fraternity, fellowship and society of persons whether corporate or not corporate. S59(b) says that any partnership dealings shall be treated as dealings by the partners and not by the firm as such. Is the holding of the shares a partnership dealing? One would have thought so. But then the same wording appears in section 59A for LLPs (and presumably also applies to SLPs) which are regarded as bodies corporate and therefore persons in their own right. What is HMRC's view?

List of meetings held and respondents to July 2014 Update Report

ACCA (Essex Branch)

Allen & Overy LLP

Baker Tilly LLP

Berwin Leighton Paisner LLP

Bishop Fleming Accountants (Plymouth)

British Private Equity & Venture Capital Association (BVCA)

Chartered Institute of Taxation

Deloitte LLP

Grosvenor Group Ltd

HM Revenue & Customs

Martin Edward Gunson

ICAEW (Farming and Rural Business sub-committee)

ICAS

Roger Jones

PricewaterhouseCoopers LLP

Smith & Williamson LLP

In addition, points relevant to our partnerships work were raised in a number of evidence-gathering meetings on our Competitiveness project.

D HMRC response to OTS interim report proposals

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
1	Partnerships taxation interim report, page 5	The "one size fits all" approach of partnership tax leads to extra burdens and complexities for small partnerships, when compared to sole traders with similar sized businesses. The tax system needs to take a more strategic approach to partnerships.	Partly	*HMRC does not agree that tax policy and administrative processes "have often been designed with sole traders and corporations in mind and with partnerships included as an afterthought".* *HMRC is taking forward cross-directorate work to look at what more it can do to provide a more strategic, joined-up service to its partnership customers*
2	Partnerships Taxation interim report, page 5	External perception that HMRC generally treats partnerships, and LLPs in particular, as if they were exclusively avoidance vehicles.	No	*HMRC treats partnerships in the same way as all taxpayers – it is committed to helping partnerships and partners get their tax right, but relentless in pursuing those who bend or break the rules.* *It is certainly* **not** *HMRC's view that partnerships, and in particular LLPs and partnerships with corporate partners, are set up for tax avoidance purposes.* *HMRC believes that partnerships, including LLPs, are important and legitimate commercial structures and the majority do not disguise employment relationships, nor do they manipulate*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
				business profits, losses or assets in ways that reduce their tax liabilities.
3	Partnerships Taxation interim report, page 5	Partnerships tax rules are spread out across legislation and guidance	No	*The OTS states in the report that there is little desire for a consolidated taxes act for partnerships amongst external stakeholders – they felt that partnerships legislation, although disjointed, actually worked. The idea for a consolidated partnerships tax act was welcomed in theory but not in practice, as it would lead to duplication and an even longer tax code.*
4	Partnerships Taxation interim report, page 19	Is there a way of reducing the administrative burdens faced by small partnerships? The aim would be to eliminate what can be double reporting of the same income figures. One possible route would be to remove the partnership return.	Under Review	*HMRC updates:* *HMRC is committed to reducing the administrative burden for all our customers, including partnerships.* *Filing partnership profits and allocation of partnership profits on the individual partners' returns would involve duplication of effort and add to the administrative burdens, especially for partnerships with large numbers of partners. In addition, removing the partnership return could potentially impact on HMRC compliance activities and the information contained within the partnership tax return would still need to be reported to HMRC.* *Our future strategy is to make the fullest use of data from partnerships and collect less data from individual partners, and we believe that this offers greater potential to reduce the administrative burdens faced by small partnerships than abolishing the partnership return.*
5	Partnerships Taxation	Can the default partnership agreement in the 1890 Act	Partly	*HMRC has discussed this proposal in detail with BIS and OTS. HMRC will publish guidance outlining some of the key areas to be*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
	interim report, page 21	be updated and publicised to apply in the absence of a formal agreement?		*considered as part of any partnership agreement, and this will be included in HMRC's consolidated guidance.*
6	Partnership taxation interim report, page 21	HMRC to create free software for the smallest partnerships.	No	*HMRC provides free software for the majority of its customers. For those where free software is not currently available, commercial software can be used to file online. HMRC provide links to this software on its website.* *Production of free software for partnerships would involve significant costs, and other departmental priorities offer much better value for money. In addition, it may be more helpful for commercial software providers to address this more specialist area of the market.*
7	Partnerships Taxation interim report, page 22	How can smaller partnerships be better educated about their obligations?	Under review	*HMRC sets out to ensure that it provides clear guidance on the tax obligations for partnerships, however, the Department agrees that it would be helpful for partnerships to be better educated about all their obligations.* *HMRC would welcome working with the OTS, members of the Consultative Committee and other interested stakeholders to consider what more could be done to educate small partnerships.*
8	Partnerships Taxation interim report, page 26	We would like to review how best to apply the Annual Investment Allowance to mixed-member partnerships without introducing complex anti-avoidance rules	Under review	*AIA is not currently available to any mixed partnerships of individuals and corporates. AIA was intended to be a simple relief and there were concerns when the legislation was introduced that complex anti avoidance rules would be needed to stop potential avoidance involving individuals setting up related corporate partners.* *HMRC is currently considering this issue further.*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
9	Partnership taxation interim report, page 27	HMRC should change the corporation tax self assessment return to include a section for income from a partnership.	Under review	*HMRC are already looking at the best way for companies to report partnership income i.e. how this could best be achieved and to what timetable.*
10	Partnership taxation interim report, page 29	It would be useful to have a form of general remittance basis investment relief for groups of non-domiciled individuals investing in UK investment partnerships.	Under review	*HMRC is considering this proposal in more detail, however, it is very likely that the costs associated with this change will rule out taking this proposal further.*
11	Partnership taxation interim report, page 29	HMRC needs to work more on ensuring double taxation agreements fully deal with partnerships.	Yes	*The UK works closely with the OECD and EU. It has an extensive network of tax treaties which prevent double taxation of individual partners. The UK follows the conclusions of the OECD's 1999 review of the application of double taxation agreements to partnerships and has, where necessary, included provisions in its treaties to confirm their effect. In addition the UK is participating in OECD work to further clarify the application of tax treaties to partnerships and other transparent entities.* *Although treaties give relief to each UK resident partner, HMRC procedures can be accessed by the partnership and generally work well. Where HMRC is made aware of difficulties it engages with the foreign tax authority to remove obstacles to obtaining any relief that is due.*
12	Partnership taxation interim report, page 30	There is a need to ensure developing business structures e.g. nested partnerships are dealt with by the tax system. The best	No	*HMRC works with representative bodies under its "Working Together" initiative both locally and nationally. The International Sub-Group of HMRC's Business Liaison Forum also provides another avenue to discuss partnership structural and international matters.*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
		way to do so may be a permanent HMRC/HMT/business liaison group to develop solutions on how to properly tax emerging business structures.		
13	Partnerships Taxation interim report, page 32	We would like to research further the international and technical issues faced by partnerships so as to develop a list for taking forward	Under review	*HMRC would be happy to discuss with the OTS any concerns they may have and to investigate further on the detail that OTS may provide, if this proves necessary.*
14	Partnerships Taxation interim report, page 35	There is a need to review the complexities caused in opening years by basis periods and overlap relief to assess whether a simpler method of giving overlap relief would be sensible, fairer and appropriate.	Under Review	OTS noted that this is not just a partnership point. *HMRC response: This issue is not specific to partnerships. However, HMRC is considering this point as part of a more general review into the way the rules around basis periods and overlap relief operate.*
15	Partnership taxation interim report, page 39	Tax returns for partnerships can be simplified by simplifying basis periods for non-trading income for partnerships, probably by being able to sweep small amounts of interest or property income into trading income.	Under review	*HMRC will consider this point as part of a more general review into the way the rules around basis periods and overlap relief operate.*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
16	Partnerships Taxation interim report, page 39	Allowing partners to claim business expenses on their personal returns would be a substantial simplification.	No	*HMRC comments: Increasing the complexity of the partnership – partner arrangement, such as allocating partnership expenses to individual partners, would be likely to add further significant burdens to the administration of partnerships and partners, and not reflect the true profit or loss of the partnership business or the individual partners. This may also have significant Exchequer costs and raise compliance issues. Given this, it is unlikely that this proposal will be taken forward.* OTS update: we do not accept the HMRC response which contradicts the evidence we have gathered. We are continuing to test our recommendation during our continuing partnership work.
17	Partnership taxation interim report, page 43	The process for issuing unique taxpayer references (UTRs) to foreign partners needs to be streamlined.	Under review	*HMRC has recently simplified the process for some non-UK resident partners, and will review the scope for further simplification.*
18	Partnership taxation interim report, page 44	The law on gift aid should be changed to allow partnerships to claim relief, paralleling companies.	Under review	*The Gift Aid rules for companies operate in a very different way from those for individuals, and the proposal would create inconsistencies with the tax treatment for unincorporated businesses when compared to partnerships, and would involve a major change in primary legislation.* *Allowing Gift Aid on donations by partnerships would require significant legislation around the Gift Aid declaration and attributing the donations and tax to individual partners. This would likely introduce complexities for the partnership and the individual partners.* *The alternative might be to treat the partnership as though it were*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
				a company and provide a new tax relief against profits. This means that all the relief would go to the business and the charity wouldn't be able to claim the BR tax relief. This is very likely to reduce charity income (experience is that donors do not usually increase their donations to take account of their tax relief). It would, however, be a brand new tax relief and would very likely open up obvious questions as to why sole proprietor businesses shouldn't also get the relief. All of this means additional complexity through changes in processes, less income for charities and risks for the Exchequer. *HMRC policy and technical colleagues responsible for Gift Aid have met OTS colleagues to discuss the various issues in this area in much more detail, and it has been agreed to have further discussions.*
19	Partnership taxation interim report, page 45	Penalties for partnerships around late filing of the partnership return need to be reviewed with the aim of making them fairer and easier to administer. Linked to this would be a review of appeal rights of partners.	No	*HMRC do not believe these penalties to be unfair, and the current structure is relatively straightforward.* *Every partner has a responsibility to ensure that the partnership's obligations are met. The current penalty structure was introduced as part of the review and modernisation of HMRC's powers and deterrents which were subject to extensive consultation and Parliamentary scrutiny, and received widespread external support.* *Differentiating our approach to penalties between partners in any way would introduce far more complexity for everyone and be more resource intensive than the current, simple approach.* *HMRC has been working very closely with the OTS on its recent review of penalties.*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
20	Partnership taxation interim report, page 50	HMRC's Statement of Practice D12 for capital gains of partnerships should be tidied up to reflect modern-day business practice.	Yes	*HMRC recognises that it would be helpful to update the language used in parts of Statement of Practice D12 for capital gains of partnerships. HMRC also welcomes the recognition by the OTS that Statement of Practice D12 cannot feasibly be legislated.* *HMRC has had helpful discussions with the OTS and members of the OTS Consultative Committee to obtain a better understanding of those areas of the Statement where the language needs to be reviewed, and work is now being taken forward on this following these discussions.*
21	Partnership taxation interim report, page 51	HMRC to clarify when partnerships are eligible for entrepreneurs' relief (particularly regarding possible relief on subsidiary companies held by an LLP).	Yes	*HMRC will revise its guidance to clarify when entrepreneurs' relief is due. This revised guidance will then be included in the HMRC consolidated partnership tax manual.*
22	Partnerships Taxation interim report, page 55	What circumstances, if any, would trigger a stamp duty charge on partnerships; whether there are necessary or whether it would be possible to abolish stamp duty in relation to partnerships	Under review	*HMRC has drawn to the attention of our 'Working Together' Steering Group the OTS partnership review stamp duty proposals. HMRC will be taking forward discussions on this proposal through a sub-group, with a view to considering with sub-group members whether this proposal could be progressed without creating inequity in treatment with other investors. An OTS nominee has now joined the Working Together Group on Stamp Taxes.*
23	Partnership taxation interim report, page 55	HMRC guidance should be clearer on stamp duty land tax (SDLT) liabilities following changes in profit sharing ratio	Yes	*HMRC works closely with stakeholders on a continuing basis regarding SDLT rules and guidance. We will examine this area and strengthen existing guidance which will then be included in the HMRC consolidated partnership tax manual.*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
24	Partnership taxation interim report, page 55	There is a strong argument for an equivalent to s105(4)(b) IHTA to be available for partnerships, as this reflects how such entities are being used.	No	*Any difference in treatment between a company and an LLP would involve changes to primary legislation. HMRC believes that this would need to be considered as part of a much wider review of Business Property Relief and other IHT legislative changes.*
25	Partnerships Taxation interim report, page 56	Should there be a formal rule in SDLT that no tax will apply in partnership unless cash changes hands?	Under review	*HMRC will work closely with its 'Working Together' Steering Group to better understand the circumstances where SDLT charges can arise when cash does not change hands, and whether this should continue to be the case. An OTS nominee has now joined the Working Together Group on Stamp Taxes.*
26	Partnership taxation interim report, page 59	HMRC to clarify their requirements as regards limited partnerships and joint ventures for the purposes of VAT registration, where the present published guidance seems unclear	Yes	*This is covered in revised guidance on VAT registration which has now been published online - (limited partnerships)* http://www.hmrc.gov.uk/manuals/vatregmanual/VATREG09300.htm *and (joint ventures)* http://www.hmrc.gov.uk/manuals/vatregmanual/VATREG10000.htm) *Guidance on Scottish partnerships is available online at* http://www.hmrc.gov.uk/manuals/vatregmanual/VATREG09420.htm *This revised guidance will be included in the consolidated partnership tax manual.*
27	Partnership taxation interim report, page 59	HMRC to give clear guidance on VAT grouping for LLPs.	Yes	*This is covered in revised guidance on VAT registration which has now been published online* (http://www.hmrc.gov.uk/manuals/vatregmanual/VATREG09600.htm). *This revised guidance will be included in the consolidated partnership tax manual.*

Number	OTS report page	OTS recommendation	HMRC response	HMRC comments
28	Partnership taxation interim report, page 59	Requirement for all partners to sign form VAT 2 needs to be removed or (probably) advantage needs to be taken of digital procedures to finesse a cumbersome requirement and eliminate duplication.	Under review	*The VAT 2 form provides legal confirmation that all of the signatories acknowledge their status as partners in the firm. This requirement cannot be removed. If HMRC were to accept simple lists of partners, it could end up pursuing the partnership's debts against individuals who had no idea that they had been listed as partners.* *However, partnerships which use the new digital online registration service can provide an equivalent confirmation by giving specified personal details for each partner. HMRC will therefore look into aligning the information requirements on the VAT 2 form with those on the digital online registration system.*
29	Partnership taxation interim report, page 59	VAT penalties for failure to notify a change from sole trader to partnership status need to be changed so that there is no penalty where no tax is lost, except for a repeat failure.	No	*HMRC considers that its approach to charging penalties where there has been a transfer of a going concern is reasonable and fair. However, a penalty may be reduced to an appropriate level through a special reduction in certain circumstances including where the right tax was paid at the right time (albeit via the wrong entity).* *HMRC has been working very closely with the OTS on its recent review of penalties.*

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This document can be found in full on our website at:
https://www.gov.uk/government/organisations/office-of-tax-simplification

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