



HM Revenue  
& Customs

# Partnership taxation: proposals to clarify tax treatment

## **Consultation document**

Publication date: 9 August 2016

Closing date for comments: 1 November 2016

<b>Subject of this consultation:</b>	As announced at Budget 2016, the government is consulting on how partnerships calculate their tax liabilities. This consultation includes a number of areas where the taxation of partnerships could be seen as uncertain in the context of the wide variety of modern partnerships.
<b>Scope of this consultation:</b>	The government has developed proposals for change in a number of areas and is seeking views to inform the detailed policy design.
<b>Who should read this:</b>	Those with an interest in how partnerships and limited liability partnerships are taxed under the income tax and corporation tax rules, including advisors and representative bodies.
<b>Duration:</b>	12 weeks from the start date of the consultation.
<b>Lead official:</b>	Robert Nott
<b>How to respond or enquire about this consultation:</b>	Responses can be sent by email to: <a href="mailto:Robert.Nott@hmrc.gsi.gov.uk">Robert.Nott@hmrc.gsi.gov.uk</a> or by post to:  Robert Nott HM Revenue & Customs Room 3/64 100 Parliament Street London SW1A 2BQ  Enquiries can be made via email as above or please telephone:  Robert Nott 03000 537413
<b>Additional ways to be involved:</b>	HMRC would welcome discussions with interested parties on any aspect of the consultation. Depending on the level of interest HMRC may organise working groups as a forum for dialogue. Please use the contact details above if you would be interested in participating.
<b>After the consultation:</b>	The government will consider all responses and will publish a summary of responses after the consultation.
<b>Getting to this stage:</b>	One of the issues covered in the consultation- tiers of partnerships- was identified by the Office of Tax Simplification's Partnership Review as a business structure which the tax system needed to cover.
<b>Previous engagement:</b>	This is the first formal engagement with interested parties on these issues.

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# 1. Introduction

- 1.1. This consultation is relevant to general and limited partnerships, including foreign entities classified as partnerships for UK tax purposes. It also applies to Limited Liability Partnerships (LLPs) carrying on a business with a view to profit, which are treated like partnerships for income and corporation tax purposes.
- 1.2. The consultation covers areas where the government has identified that the tax rules may be seen as unclear or produce an inappropriate outcome. These are set out in the following chapters:  
  
Chapter 2: Clarification of who is the partner chargeable to tax  
Chapter 3: Business structures that include partnerships as partners  
Chapter 4: Investment income - tax administration  
Chapter 5: Trading and property income - tax administration  
Chapter 6: Allocation and calculation of partnership profit.
- 1.3. It will have no effect on the vast majority of partnerships. It seeks to provide clarity in particular circumstances where the current rules are seen as creating uncertainty.
- 1.4. The government recognises that partnerships and LLPs are flexible vehicles that are used by a wide range of businesses, and proposes changes to the income tax and corporation tax rules to ensure these fit with modern commercial practice.
- 1.5. The object of the proposals is to remove uncertainty by making the calculation and reporting of partnership profits clearer for taxpayers. This will prevent unnecessary costs for compliant taxpayers and reduce the scope for non-compliant customers to avoid or delay paying tax.

## **Calculation of partners' profits**

- 1.6. A partnership is defined as the relationship which subsists between persons carrying on business in common with a view to profit. A partner may therefore be any person who meets this definition including an individual, a company, or an LLP.

- 1.7. Partnerships are not taxed on their profits; instead individual partners are chargeable to income tax on their share of the partnership profits and to capital gains tax on their gains in respect of partnership assets. Corporate partners are chargeable to corporation tax on their share of profits and chargeable gains.
- 1.8. A partnership calculates its taxable profit or loss using the tax rules that apply to the partners, with different rules applying for income and corporation tax purposes, and for UK resident and non-UK resident partners. A partnership consisting of resident and non-UK resident companies and individual partners may therefore have to prepare four computations to arrive at the taxable partnership profit.
- 1.9. Once the partnership profit has been established, the partnership allocates a share of the profit or loss (calculated on the basis appropriate to the partner) to each partner in accordance with the partnership profit sharing agreement. This is the partner's share of the partnership profit.
- 1.10. A nominated partner is required to make a return on behalf of the partnership. This includes a statement that names all the partners, the taxable partnership profits or losses and the amount of profit or loss allocated to each partner.
- 1.11. A partner is normally required to include their share of the profits or losses in their personal or company tax return and pay tax on their share of profit.
- 1.12. As each partner is responsible for the tax on their share of the profits a partnership is often described as being "transparent" for tax purposes. This simply means that the tax rules look through the partnership and tax the profits on the partners.
- 1.13. For the vast majority of partnerships the process of calculating the partnership's profit and each partner's share of the partnership profit is well understood and applied correctly. However, the government is aware that there are some areas where there is uncertainty or ambiguity and this has also been highlighted in the Office of Tax Simplification review into partnership taxation<sup>1</sup> and in leading textbooks on partnership taxation.

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<sup>1</sup> Office of Tax Simplification Review of Partnerships January 2015

## 2. Clarification of who is the partner chargeable to tax

- 2.1. In most cases it is clear who is a partner for tax purposes, as the Taxes Acts follow the position under the Partnership Act 1890, the Limited Partnership Act 1907 (LPA) or the LLP Act 2000 (LLPA).
- 2.2. Partners in Limited Partnerships (LPs) and Limited Liability Partnerships (LLPs) must register at Companies House, in contrast to partners in general partnerships. In an LP the partner for tax purposes is the person registered under section 8 or 9 of the LPA. In an LLP the member treated as a partner for tax purposes is the person who meets the definition of member in Section 4 of the LLPA<sup>2</sup>.
- 2.3. The government is aware of a limited number of situations where taxpayers or their advisers are contending that application of the normal rules is causing uncertainty or producing a wrong outcome. In some cases the partners on the Companies House register are different from the partners reported to HMRC on the partnership return.
- 2.4. Typically, this concerns situations where individuals or corporate entities named as partners in a partnership or members of an LLP argue that they are not liable for tax because they are acting as a “nominee” or an agent for someone else. The government believes that the application of the current law is clear and that a partner cannot act in the capacity of a nominee or agent for another person. The government proposes to act to remove any uncertainty in this area.
- 2.5. **Proposal 1:** The government proposes that for tax purposes a person will be treated as a partner in a partnership if they are notified to HMRC as partners in the partnership return.

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

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

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<sup>2</sup> There is an exception. Since April 2014, a member whose terms of membership are similar to those of an employee rather than a traditional partner is treated for tax purposes as a “salaried member” and taxed as if they were employees.

### 3. Business structures that include partnerships as partners

- 3.1. The tax treatment of business structures which include other partnerships or LLPs as partners, such as those involving chains or tiers of partnerships, can be misinterpreted in some circumstances, as highlighted in the OTS Partnership Review. As explained in Chapter 1, partnerships are generally treated as transparent for income and corporation tax purposes and the partners pay tax on their share of the partnership profit, as shown in the partnership return and statement.
- 3.2. The government recognises that many Investment Funds use structures that include partnerships. Funds structured in this way will not be affected by the proposals in this chapter, but are considered separately in Chapter 4.
- 3.3. HMRC relies on the information in the partnership return and statement to identify the partners and the profits and loss allocated to each partner. If the return and statement provide the names of partners who are not chargeable to tax, for example an LLP or another entity generally regarded as transparent for tax purposes, HMRC does not know who is ultimately chargeable to tax on the partnership profit share.
- 3.4. The government recognises that LLPs and other entities which are regarded as transparent for tax purposes can be partners, and that businesses may want to include such entities as partners for legitimate commercial reasons.
- 3.5. The government is committed to treating such entities as transparent for tax purposes, but proposes changes to the reporting requirements so that it is clear who will actually be responsible for paying tax on the profits of the reporting entity.
- 3.6. The government believes that it is important to provide certainty of tax treatment for taxpayers using these structures, particularly in view of the move towards digital reporting. The government therefore proposes to 'look through' the partnership or LLP that is the partner in the first partnership and to treat the partners in that other partnership or members of that LLP as partners in the first partnership. Where the partners in the second partnership or members of the second LLP are themselves a partnership or an LLP, the treatment will 'look through'



those entities until the economic and beneficial owner of the profit share, the 'ultimate partner', is identified.

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

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

## 4. Investment income - tax administration

- 4.1. The investment management industry is important to the UK economy, accounting for 1% of GDP and a key part of the wider financial services sector. The government's Investment Management Strategy exists to maintain the UK's competitiveness so that the industry continues to be based in the UK.
- 4.2. The government considers that the tax legislation should also be amended to cater for partnerships solely with investment income. Currently there are no special provisions for investment funds which are structured as partnerships, which are taxed in the same way as ordinary partnerships. This creates administrative problems as the funds can have large numbers of partners, many of whom may be non-UK resident or entities which are not taxable, but the same return and filing requirements apply.
- 4.3. The government wants to consider ways in which the administration could be improved whilst ensuring that HMRC and investors have the information they need to report the right amount of income and tax.

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

## 5. Trading and property Income - tax administration

- 5.1. Where a partnership carries on a trade or property business, then the considerations are quite different to those in relation to investment income discussed in Chapter 4. In particular, non-residents will typically have tax liabilities in relation to UK trading or property business profits.
- 5.2. The government believes that the current tax administration requirements for partnerships, including provision of Unique Taxpayer References and profit shares for all partners entitled to a share of the trading or property business profits should continue to apply in general.
- 5.3. However, the government also recognises that there may be rare situations (for example in some structures where one partnership is a member of another, discussed in Chapter 3) where the nominated partner of the partnership that is carrying on the taxable activity may be unable to establish the details of all the partners or obtain UTRs from all of them. A workable approach to protect the Exchequer is needed to deal with any such situation.
- 5.4. **Proposal 4:** The government wishes to explore options for protecting the Exchequer where the details of partners entitled to trading or property business partnership profits are not provided by the partnership. One such option could include a payment being made on account to HMRC on behalf of any partners who are not identified.

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

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

## 6. Allocation and calculation of partnership profit

- 6.1. The government has also identified the following areas where the allocation or calculation of a partner's profit is unclear or could lead to an inappropriate outcome.

### ***Profit sharing arrangements***

- 6.2. In general, a partner's share of a partnership's profits is determined by a written profit sharing agreement and there is no dispute as to the amount of the partner's share. However, there is no legal requirement that profit sharing arrangements must be specified in writing. The terms of a partnership or LLP agreement may also be amended subject to any terms that have been agreed by the partners. There is therefore potential for uncertainty where partners dispute the allocation of profits made to them for tax purposes on the basis that the actual profit sharing arrangements are different from the written agreement or as stated by the nominated partner.
- 6.3. **Proposal 5:** In order to provide certainty, the government considers that legislation should be introduced to confirm that the profit sharing arrangements as set out in the partnership or LLP agreement are the determining factor in identifying the partners' profit shares.
- 6.4. However, in order that the flexibility of partnerships is maintained this proposed default position could be overridden by notification to HMRC from the nominated partner of the partnership or LLP, in either written or electronic format, of any changes to this agreement.

### ***Allocation of tax adjusted profit to partners***

- 6.5. A partner's share of a profit or loss is normally determined for tax purposes in accordance with the partnership's profit sharing arrangements during a period of account. Profit sharing arrangements are defined as the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade. The provisions also apply to businesses that are not trades.
- 6.6. In general, the definition does not cause any difficulties. However, the government is concerned that this flexibility is seen by some partnerships as an opportunity to manipulate profit, loss and capital gains allocations for tax purposes. For example, by allocating specific items of income and expenditure to particular partners or classes of

partner or by determining profit shares after the end of the accounting period.

- 6.7. The government is confident that the current rules do not support the manipulation seen to date and HMRC has been successful in challenging such arrangements. However, the Government proposes amending the current rules to put the matter beyond doubt and remove the risk of loss of tax.
- 6.8. **Proposal 6:** Legislation would be introduced to provide that the basis of allocation of tax adjusted profit should be the same as the allocation of the accounting profit or loss between the partners. This legislation would apply to both partnerships and LLPs. Partners or members would only share in profits or losses for the period in which they were partners or members.
- 6.9. In some cases, the current rules do not explain how to calculate the profit of a partnership, or may lead to inappropriate profit calculations for particular types of partner.

#### ***Companies chargeable to income tax***

- 6.10. The profits of company partners liable to income tax are calculated as if the company was an individual. For example, the profits of a non-UK resident company partner in a firm which carries on a UK property business are calculated as if the company was an individual as opposed to being calculated as a company.
- 6.11. **Proposal 7:** Legislation would be introduced to provide that the profits of company partners liable to income tax will be calculated as if a non- UK resident company were carrying on the business.

#### ***Non-chargeable persons***

- 6.12. The current rules do not explain how to calculate the partnership profit or loss where the partner is not a person within the charge to income or corporation tax, as set out in Chapter 3.
- 6.13. Chapter 3 explains how the government proposes to change the rules to cater for situations where a partner is itself a partnership. The proposals will apply to any partner that is not a person within the charge to income or corporation tax. If the nominated partner in the first partnership does not provide details of the ultimate partners, the proposal at 3.7 will apply and the share of profit or loss will be calculated as if the partner was a UK resident individual.

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

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

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

## 7. Assessment of Impacts

### Summary of Impacts

Exchequer impact (£m)	2014-15	2015-16	2016-17	2017-18	2018-19
	+/-	+/-	+/-	+/-	+/-
	The Exchequer impact of proposed changes will be costed following consultation and will be subject to scrutiny by the Office of Budget Responsibility.				
<b>Economic impact</b>	The economic impact of any proposed changes will be considered following consultation				
<b>Impact on individuals, households and families</b>	Negligible				
<b>Equalities impacts</b>	Negligible as the impact on individuals is negligible.				
<b>Customer cost impact</b>	The impact of any potential change on administrative burdens will be explored as part of the consultation. However the aims of providing certainty includes reducing burdens.				
<b>Impact on businesses and civil society organisations</b>	The number of businesses affected and the impacts of any potential change will be explored as part of the consultation.				
<b>Operational impact (£m) – [HMRC or other]</b>	This will be explored as part of the consultation however providing certainty should reduce HMRC intervention and hence reduce costs.				
<b>Other impacts</b>	Other impacts have been considered and none have been identified.				

## 8. Summary of Consultation Questions

### Clarification of who is the partner chargeable to tax

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

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

### Business structures that include partnerships as partners

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

### Investment income - tax administration

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

### Trading and property income - tax administration

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

## Allocation and calculation of partnership profit

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



## 9. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 1 of the process. The purpose of the consultation is to seek views on the policy design and any suitable possible alternatives, before consulting later on a specific proposal for reform.

### How to respond

A summary of the questions in this consultation is included at chapter 8.

Responses should be sent by 1 November 2016, by email to [Robert.nott@hmrc.gsi.gov.uk](mailto:Robert.nott@hmrc.gsi.gov.uk) or by post to:

Robert Nott  
HM Revenue and Customs  
Room 3.64  
100 Parliament Street  
London SW1A 2BQ

Telephone enquiries 03000 537413

**Please do not send consultation responses to the Consultation Coordinator.**

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC's GOV.UK pages](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

## Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

## Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

John Pay, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: [hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk](mailto:hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk)

**Please do not send responses to the consultation to this address.**