



TAXREP 02/14

(ICAEW REP 10/14)

ICAEW TAX REPRESENTATION

DRAFT FINANCE BILL 2014 CLAUSES, INCLUDING PARTNERSHIP TAX

Comments submitted on 24 January 2014 by ICAEW Tax Faculty in response to the House of Lords Economic Affairs Committee Finance Bill Sub-committee call for evidence in connection with its inquiry into Finance Bill 2014 draft clauses, including the taxation of partnerships

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INTRODUCTION

1. ICAEW welcomes the opportunity to provide evidence in connection with the House of Lords [Economic Affairs Committee: Finance Bill Sub-committee's call for evidence for its inquiry into the Finance Bill 2014](#) draft clauses, including the taxation of partnerships. Comments have been invited on two topics, namely:
 - The partnership provisions in the draft Finance Bill clauses published on 10 December 2014; and
 - The new approach to tax policymaking.
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a professional membership organisation, supporting over 142,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.
5. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.
6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

TAXATION OF PARTNERSHIPS

7. The Draft Finance Bill 2014 clauses propose legislation affecting four aspects of partnership tax:
 1. Limited Liability Partnerships (LLPs): salaried members
 2. Partnership with mixed membership
 3. Alternative Investment Fund Managers: Deferred remuneration etc
 4. Disposals of assets through partnerships
8. In this submission, we confine our comments to the first two of these proposals as these will be of the greatest concern to a large number of partnerships.

General points

Key observations regarding partnership tax structure

9. The law on partnerships dates from the Partnership Act 1890. A partnership is transparent for tax purposes. Consequently, although a partnership must submit a tax return each year showing the partnership profits, any profits are allocated to the partners and taxed on them, with individual partners paying income tax in respect of any allocated share of partnership profits through their own personal tax returns.
10. Limited liability partnerships (LLPs) were introduced in 2000 to provide an alternative business structure. However, the tax rules for LLPs follow those for ordinary partnerships.

11. All partnerships are treated in the same way no matter how many partners are in the partnership. Historically there were some limits on the number of partners that could form a partnership although many types of professional partnerships were exempted from this requirement and in 2002 the upper limit was abolished entirely. The vast majority of partnerships in the UK have only two or three partners, but some (usually professional) partnerships are very large, with 500 partners or more.
12. The tax rules for partnerships are not always easy to understand. Most of the guidance on practical application and practices for taxing partnerships is set down by HMRC in guidance.

Employment law vs tax law

13. The increasing divide between employment law and tax law leads to more uncertainty, complexity and unfairness as individuals are taxed as employees, but without equivalent employment rights. The proposals to tax LLP salaried partners as employees will add a further group of individuals who will be in this position.

Complexity and the effect of the rules on LLPs

14. The papers and supporting documents, published on 10 December 2013 run to a total of 117 pages. The draft legislation is highly complicated and we are still analysing the detail of the proposals.
15. We are concerned that the proposals are too complex for practical implementation and are disproportionate to the problems they are attempting to resolve. The stated intentions of the proposals are to level the playing field and to tackle tax avoidance, but we are not convinced these proposals support the objectives.
16. LLPs are a flexible and competitive commercial structure and, since they were introduced, the number of them has grown considerably. However, the inherent complexity and uncertainty of these new rules will significantly undermine the commercial case for using an LLP. There are serious commercial implications to this new legislation and we consider it likely that businesses will now favour using a company structure, even if an LLP might have been a better structure.
17. The anti avoidance legislation in new s863C, ITTOIA 2005 is particularly difficult to understand and appears to rely on deciding whether arrangements have been put in place with a main purpose of ensuring that someone is not a salaried member. On our reading of this legislation, potentially all salaried members would be within the legislation.
18. Example 17 of the Technical guidance provides a simple illustration of the problem:

P has been an employee of the DEF LLP. She has reached that point in her career where she is offered membership.

In order to become a member, P needs to invest in the LLP. She has some capital of her own, and the LLP arranges with the Bank for her to have a normal commercial loan to cover the balance. An undertaking is given that on P's retirement from DEF LLP, the firm will pay back the loan directly out of P's capital account and, if necessary, any undrawn remuneration, with full recourse against P if these amounts prove insufficient.

These arrangements have been put in place to enable P to become a full member of the DEF LLP. They have not been put in place to enable P to evade (sic) being a Salaried Member. P faces genuine risk, she has invested in the DEF LLP and does owe the Bank money, which she will need to repay and, in the interim, she will have to pay interest.

19. In our view, becoming a full member, on terms akin to those of a partner in a traditional partnership, is not avoiding being a Salaried Member and should clearly not be within the ambit of the legislation. While we are pleased with this conclusion, and with the other

examples designed to show the working of the Salaried Members test as a whole, we do not consider this compensates for the overly complex legislation itself. This appears to be another example of ‘taxed according to the law but untaxed by concession’.

20. Furthermore, part of the rationale behind the new rules is to stop profits being held in corporate form; but this will still happen using simpler corporate structures instead.
21. The Office of Tax Simplification has been conducting a review of partnership tax, the results of which were published on 22 January 2014. Introducing complex legislation which will affect many businesses, potentially leading to structural change while the results of the review are still being considered, seems an unnecessary complication and does little to provide much needed stability and certainty to the UK tax system.

Compliance costs

22. These proposed new rules introduce a significant additional compliance cost for LLPs. These are complex rules that will impact on setting up new business structures and then again to any changes in business structures. Seeking advice on such rules will always tend to be more expensive due to its highly specialist nature.
23. The guidance runs to 56 pages and includes numerous examples to assist users. While this is most welcome and helps users to understand the intended application, it is no substitute for simple and clear legislation. The rules appear to be quite widely drafted and potentially catch a number of situations which we do not think should be caught.

Limited liability partnerships: salaried members

24. We agree that there should not be a presumption of self-employment for a member of an LLP, but conversely nor should there be a presumption of employment.
25. HMRC’s guidance states that ‘The salaried member legislation is being introduced so that those members who are effectively in the position of employees will be taxed as employees whilst those members who are in a position equivalent to partners will continue to have the same tax treatment as partners.’ The proposals do not achieve this. To do so, any tests should be by reference to the existing status test rules for income tax. Instead, we have an entirely new set of tests proposed as new s 863B, ITTOIA 2005.
26. The existing rules for determining an individual’s employment status could be used for an LLP. Since a large number of LLPs are likely to be professional partnerships, these are most likely to have the expertise necessary to interpret the existing status test rules correctly. Thus, further law should not be necessary.
27. These proposals suggest that the existing law for identifying whether a person is employed or self employed is inadequate. If so, then we would have thought that those rules need to be reviewed and a comprehensive rule introduced that works for all business forms.
28. The key issue here remains the disparity between the tax cost of employment as opposed to self employment. This is a structural problem within the tax system caused by employers’ NIC. This difference creates tension for many more taxpayers than just those in partnerships and is particularly problematic for freelancers.

Practical problems

29. There are numerous practical problems with the detail of the legislation. Four examples given to us by our members so far include:
 1. The new subjective tests: “reasonable to expect” in new s 863B(1)(b), and “reasonable to suppose” in new s 850C. Reasonable for whom? This introduces considerable uncertainty.

2. The definition of disguised salary in new s 863B(2) will catch profit pools comprising bonuses that are to be allocated on different bases.
3. The application of conditions B and C in new s 863B could cause problems in normal circumstances for larger professional firms. For example, a partner may not be on the management committee so may not have significant influence. Further many professional practices either do not need significant capital, relative to profits, or may be largely financed by outside, third party, finance.
4. Consider partnerships where profit shares are partly based on non-profit factors. For example the profit share might be based to a significant degree on growth or departmental targets, and to some extent on peer review or technical issues. Larger accountancy firms do not always base all profit shares simply on profit. At a simpler level, some firms rely on insolvency profits keeping the firm going in bad times and therefore profit share may not reflect profits in good times or in bad times when the insolvency side is supported by general practice business streams.

Implementation timetable

30. Those LLP members subject to the new legislation will be taxed as employees from 6 April 2014. This is too short a period to make any necessary changes given that at that date many LLPs will be part way through an accounting period. For example, ABC LLP has a year end of 30 April. Under the new rules, C will be treated as an employee from 6 April 2014. If the partnership decides to actually make C an employee from 2014/15, rather than just deeming him to be so for tax purposes, there is in our view insufficient time to rearrange his employment status.
31. We believe any change should apply from the start of the first accounting period after 6 April 2014.
32. We are also concerned that the Real Time Information requirements have not been considered. The new RTI penalty rules are also effective from 6 April 2014 and we believe that the combination of the two could give rise to considerable administrative burdens and practical implementation problems.

Partnerships with mixed membership

33. While we agree that the use of mixed membership partnerships for the sole purpose of avoiding tax on the profits drawn out of a business should be addressed to ensure that a fair amount of tax is paid, we do not agree with all the changes proposed.
34. The proposals fail to accommodate the commercial and historic reasons why some businesses have a mixed partnership structure. For example, many businesses hold land within a corporate partner or use such a member to build up working capital requirements. The fundamental rule of partnership tax is that all the profits are allocated each year to the partners and then each must pay their share of the tax. Of course the business could then choose to physically retain the cash representing some of the partners' profit shares, but this results in a relatively high charge on reinvestment as compared to retaining profits in a company. The use of a company within an LLP structure therefore helps to narrow the tax disincentive to retain and reinvest earnings which comes with just using an LLP.
35. Other mixed partnerships include a corporate partner as a member in order to access reliefs or tax credits only available to companies such as research and development tax credits or for employee share schemes.
36. As far as mixed partnerships are concerned, we would like to see a de minimis in order to exclude many of the smallest businesses from these proposals; we would prefer to see them excluded by legislation rather than by guidance.

The new approach to tax policymaking

The tax consultation framework

- 37.** After a period of consultation, the Government adopted the Tax Consultation Framework in March 2011. The Framework sets out five stages of consultation:
1. Setting out objectives and identifying options
 2. Determining the best option and developing a framework for implementation including detailed policy design
 3. Drafting legislation to effect the proposed change
 4. Implementing and monitoring the change
 5. Reviewing and evaluating the change
- 38.** In cases where tax avoidance was in point there might be the need to introduce measures without the prior consultation envisaged in the Framework.
- 39.** The framework has provided an improved approach to designing, developing and implementing tax policy. However, we have two particular concerns about it:
1. The impact assessments used to underpin policy changes are not based on robust and realistic costings. Two examples would suffice to illustrate the problems that arise.
 - The impact assessment that supported the introduction of RTI showed that there would be net savings to businesses of £300m a year. Given that most businesses now have to report payroll information to HMRC every month rather than once a year as previously, such a conclusion is counter intuitive. We, and others, have asked a number of times for a breakdown of how this figure was calculated but we have yet to receive a detailed response.
 - The estimate of the cost of implementing the changes to the VAT rules for the place of supply of services looks far too low. The impact assessment (which can be found at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264626/7_VAT_-_place_of_supply_and_the_introduction_of_the_Mini_One-Stop_Shop.pdf) states that 'for up to 29,000 businesses the ongoing costs are expected to be approximately £40 per business per year, and for 5,000 businesses the ongoing costs are expected to be £220 per business per year'. This suggests that businesses will incur extra costs of £10 a quarter on preparing the necessary figures. Given that many businesses (including ICAEW) are potentially affected by these rules and are likely to have to implement systems and procedures changes and ensure that they are properly reviewed and checked each time a return is made, these figures look wholly unrealistic.
 2. We welcome the improved consultation. However, we are not convinced that the Government is always listening to the responses and ensuring that the proposals are amended to take account of legitimate concerns. There is a danger that the process is still more as an end in itself rather than a means to an end, namely improved legislation that meets the Government's policy objectives while being easy and practical to implement and administer.
- 40.** The problem with these impact assessments is that the figures often appear to be based on a wholly unrealistic assessment of what changes are actually needed to implement any proposals and what management and due diligence processes are needed to ensure that any changes are correctly implemented. There is a need for consultation with business and professional advisers at an early stage to identify in detail what needs to be done and by whom so that such processes can be built in to any costings.

41. In relation to the second point, while generally the process has improved there have been some examples where this has not been the case. If we take RTI again, we raised numerous concerns during the consultation process, particularly in respect of the timetable and the need to submit returns 'on or before' the payment date. While there have been welcome changes made as a result of the consultation process, we believe there should have been greater prior recognition of the potential problems and how they could have been addressed. We also have similar concerns with the rules that were introduced imposing an annual tax on enveloped dwellings which looked to us to be largely unworkable.
42. In our meetings with Ministers we have said that we want the Chancellor to re-commit to a simpler tax system 'restore the tax system's reputation for simplicity, stability and predictability'. In our view the partnership proposals are in direct conflict with that aim.

Roadmap for personal tax

43. In November 2010, the Government published a Roadmap for Corporation Tax which has been welcomed by business. We would now like a similar document to be published for personal tax. Certainty about the taxes individuals must pay on their income and chargeable gains is a contributory factor to a business's decision to base itself in the UK.
44. The key elements of the business roadmap were:
- the main rate of corporation tax;
 - the definition of the corporation tax base;
 - the quality of tax policy-making; and
 - the way in which corporation tax is administered and collected.
45. The proposed complex new rules on partnerships and offshore intermediaries should not be allowed to impact ordinary transactions.

The consultation process in relation to the partnerships proposals

46. At Budget 2013, the Chancellor announced that the government would consult on changes to two aspects of the tax rules on partnerships in order to prevent tax loss arising from:
- disguising employment relationships through limited liability partnerships; and
 - certain arrangements involving allocation of profits and losses among partnership members.
47. It was proposed that those changes would take effect from 6 April 2014.
48. The initial proposals were published in May 2013 and we responded to those in TAXREP 35/13 where we raised a number of concerns about the proposals.
49. While some of our concerns have been addressed, the fundamental challenges we made then are still present in the revised proposals set out above.

Summary

50. In summary, while we welcome the new approach to tax policy making with its emphasis on improved consultation, we consider that Government and its advisers (both in HM Treasury and HMRC) need to do more to address the legitimate concerns on proposals expressed by business. In particular, creating more employees for tax purposes without regard to the employment law position, while underestimating the costs and not recognising that businesses may wish to retain profits for working capital, shows a failure to understand how businesses operate. The proposals fail to reflect the need for a tax system that is simple and certain to operate and which aligns with business needs.

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23 January 2014

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APPENDIX

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

The ten tenets are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)