



ICAEW REPRESENTATION 170/16

TAX REPRESENTATION

PARTNERSHIP TAXATION: PROPOSALS TO CLARIFY TAX TREATMENT

ICAEW welcomes the opportunity to comment on the consultation document [partnership taxation: proposals to clarify tax treatment](#) published by HM Revenue and Customs on 9 August 2016.

This response of 1 November 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

Key point summary

1. ICAEW welcomes the opportunity to comment on the consultation [partnership taxation: proposals to clarify tax treatment](#) published on 9 August 2016.
2. We understand that the intention of this consultation is to address areas where HMRC feel the rules have become unclear or the rules as written do not reflect commercial practice. We understand this is particularly true in respect of partners acting as agents/nominees who are named on the partnership return.
3. We are surprised that this consultation makes little reference to the implications of Making Tax Digital (MTD) on partnerships considering the implementation timetable suggests that all partnerships subject to income tax will need to adopt the new regime as of April 2018.
4. We understand that partnerships are very flexible business vehicles and there is a need to clarify the tax treatment in certain areas, however we do not think it is appropriate to make non-essential changes while the tax system is being reviewed extensively. It appears that little thought has been given as to how MTD will impact the proposed legislative changes, and whether they will indeed still be relevant once MTD is implemented. All change carries some degree of cost and we suggest a holistic approach is adopted.
5. In January 2015 the Office of Tax Simplification (OTS) conducted a [review of partnerships](#) and listed 17 recommendations for consideration by HMRC. We are disappointed that none of these recommendations have been considered in this consultation document, in particular the treatment of partner specific expenses (recommendation five of the OTS report).
6. Rather, the focus of this consultation is to consider “areas where the government has identified that the tax rules may be seen as unclear or produce an inappropriate outcome” (paragraph 1.2) which appear to be peripheral and relevant to only large and complex partnerships (as the consultation document itself states at paragraph 1.3, “it will have no effect on the vast majority of partnerships”).
7. The proposals in this consultation intend to place responsibility on the nominated partner. Where there is a lack of information (for example in structures where an LLP is a member of another LLP and foreign entities are involved) this will lead to undue administrative and possible financial burdens on a typically compliant partner.
8. We are happy to work with HMRC to understand these issues in more detail. We believe the proposals contained within this consultation document will be unworkable for the partnerships themselves and will add further to the administrative burden.

RESPONSES TO SPECIFIC QUESTIONS

CLARIFICATION OF WHO IS THE PARTNER CHARGEABLE TO TAX

Q1: 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?

9. We understand there can be difficulties in identifying the partners in a partnership, particularly where partners act as agents or nominees for other individuals, including those without a UK UTR.
10. We note that the consultation document states in paragraph 2.4 “the government believes 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.”
11. It is noted from discussions with those in the industry (and in particular the investment industry) that partners do act in the capacity of a nominee or agent for another person. This discrepancy

should to be further explored by HMRC, and where there is a business need, some degree of compromise reached.

12. We are in favour of clear and certain legislation however have some reservations regarding the proposal 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.”
13. The proposal would provide certainty of treatment in situations where all information is known and correct, and would ensure that the genuine partner or member is the taxable person..
14. However under this proposal, there will be other cases which could lead to the wrong partner being liable to tax, for example in circumstances where the partner who is acting as an agent or nominee is named on the partnership return.
15. If this proposal were to go ahead we would strongly recommend a right of appeal is available.
16. We recommend that HMRC considers how to improve the flow of information between Companies House and itself. Some form of check is required to ensure the correct information is held by both bodies.

Q2: Do you consider that the proposal would have any unintended impacts?

17. As above, the unintended impact would be that individuals who are not entitled to the profit of the partnership are taxed on income.
18. If this proposal were to be pursued, care would need to be taken to ensure that it did not mean that the position shown in the partnership return would be used for tax purposes even in cases where this was noticeably wrong. We believe further consideration is required regarding the position shown on the tax return and we question how this fits in with MTD and “the end of the tax return.”

BUSINESS STRUCTURES THAT INCLUDE PARTNERSHIPS AS PARTNERS

Q3: Are there any tax or practical issues that need to be considered in relation to this proposal?

19. We have reservations about the government’s proposal to legislate 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.”
20. The nominated partner of a partnership may not know the identity of all of the partners. This would be particularly burdensome where there are corporate partners of the first partnership/LLP and further up the chain.
21. There may be factors outside of the nominated partners control which prevent the partner from obtaining the necessary information, such as the unwillingness of partners to provide sensitive information.
22. If the nominated partner is themselves otherwise compliant with their reporting obligations, it would seem unfair to place responsibility and additional compliance on that partner due to the possibility of non-compliance by another party further up the chain.
23. In our view this proposal is not workable in its current form. Further discussion is needed to find a compromise in circumstances where HMRC needs further information.

INVESTMENT INCOME – TAX ADMINISTRATION

Q4: How do you think the tax administration of partnerships with investment income could be improved?

24. We understand that some taxpayers are unaware that investment income and capital gains are reported for the tax year rather than for the period of account as per trading income.
25. We recommend that HMRC considers legislating Statement of Practice D12 which is concerned with the treatment of capital gains for partnerships. This would support the government's intention to move away from extra-statutory concessions and replace with appropriate legislation. We would be happy to work with HMRC to see how this could be achieved most effectively.
26. Investing in a system that allocates UTRs to all partners and communicates these to nominated partners of the relevant partnership would be a significant improvement to the current system and would help to alleviate some of the existing problems.

TRADING AND PROPERTY INCOME – TAX ADMINISTRATION

Q5: 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?

27. Protecting the Exchequer is important to ensure the right amount of tax is collected.
28. We support the view that partnerships should provide HMRC with the details that they do have in respect of the partners. HMRC would then need to use their own resources to seek out further information, if required.

Q6: What practical issues would arise from the idea raised of payment on account, or from any other options to protect the Exchequer in respect of trading or property businesses profits, where information provided about partners is incomplete?

29. If a payment on account is made, would it be refundable if the partner in respect of whom it was paid was not in fact in charge to UK tax?
30. We also question how HMRC would treat refunds of amounts that were paid as income tax but should have been chargeable to corporation tax.
31. Thought would need to be given to potential double taxation issues and the availability of losses which could offset any UK tax due.
32. In cases where the absent partner comes forward and settles their tax there may be issues with the associated tax credit. The absent partner may not be aware that tax that has been deducted from their profit share in which case will not be aware that a credit can be claimed for the tax paid. HMRC might not be able to satisfy themselves as to the eligibility of any credit being claimed, because the payment on account will not have been paid to HMRC with reference to the partners' UTR.
33. The proposal to collect payments on account could have an adverse effect on the business, by taking capital out of the business which would otherwise be used to fund purchases and grow the businesses. It may also result in compliant partners needing to reduce their drawings to be able to fund these payments on account.
34. This proposal again, pursues the compliant partners rather than those whose information is absent. We believe more thought is required to target the latter.

ALLOCATION AND CALCULATION OF PARTNERSHIP PROFIT

Q7: Do you consider that the proposed clarifications would provide certainty of treatment?

35. It is unclear exactly what the mischief is here and we would welcome clarification from HMRC.

36. We are aware that it is very common for the profit sharing ratios to change without a partner being made aware. Further, an individual partner may dispute their share of profit where it was dependent upon a particular event, for example retaining a particular client of the partnership. It would therefore be wrong to expect a partner to file their tax return while remaining convinced that the partnership profit figure that they were including was incorrect.

37. It is also common practice for profit shares to be determined after the end of the accounting period to take into account activities carried out by individual partners in the period. This approach should remain.

38. We strongly believe that HMRC must revisit the issue of specific expenditure, as raised by the OTS in their review of partnerships in January 2015. The most common example of specific expenditure will be that of a car. We believe the share of partnership profit should be calculated before adjusting for partner specific expenditure, which should be deducted against the individual partners profit and not the total partnership profit.

Q8: Do you consider that the proposals would have any unintended impacts or create practical difficulties?

39. Please see the comments made in relation to question seven above.

Q9: 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?

40. The area of capital gains in partnerships is fraught with difficulty as there is little actual legislation on the topic. As raised above, we recommend that HMRC consider legislating Statement of Practice D12.

APPENDIX 1

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.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).