

A partnership tax update

(Lecture B1081 – 15.48 minutes)

In 2017, HMRC said:

‘The rules governing the calculation of partnership profits and the return of those profits are clear in the majority of situations, but their application in certain modern commercial arrangements is not always without doubt.’

The changes and clarifications set out in S18 and Sch 6 FA 2018 have emerged from a consultation process that began in August 2016. They seek to address areas of uncertainty and complexity that have been identified in recent years as problematic by advisers and other stakeholders. The new legislation can be broken down into five main parts.

Bare trusts

Part 1 of Sch 6 FA 2018 introduces a new S848A ITTOIA 2005 which deals with the circumstances where a partner acts as bare trustee for a beneficiary who is absolutely entitled to the partner's share of profits. In this case, the beneficiary is to be treated as a partner of the partnership for all tax purposes. One practical effect of S848A ITTOIA 2005 is that the partnership return will have to name the nominee partner and the beneficiary. Nominated partners (ie. the partners appointed to be responsible for making partnership returns to HMRC) will need to ensure that they are aware of all bare trust arrangements.

S848A ITTOIA 2005 applies for tax years from 2018/19 onwards.

Indirect partners in a partnership

Part 2 of Sch 6 FA 2018 inserts a definition of an 'indirect partner' into S847 ITTOIA 2005. For this purpose, an indirect partner is a person who is a partner in a partnership that is itself a partner in another partnership (referred to as an 'underlying partnership'). This relationship can be achieved:

- (i) directly; or
- (ii) indirectly, via any number of intermediate partnerships.

Hitherto, legislation has prescribed how the basis period rules, for the allocation of profits or losses, apply to individuals who are members of a partnership (see S850 ITTOIA 2005). The new 'notional trade' provisions extend these rules, for 2018/19 onwards, to members of a partnership which is itself a member of a partnership. It is not thought that this amendment will have any great significance.

New reporting requirements

Part 3 of Sch 6 FA 2018 is intended to ensure that partnerships that are partners in other partnerships will always have access to the appropriate profit calculations so that they can complete their own partnership statement accurately. This, say HMRC, 'will reduce the likelihood of errors or mistakes' and should mean that 'the correct tax is calculated for partners in such situations'.

For 2018/19 onwards, additional information in a partnership return and statement must be provided where the reporting partnership is itself a partner in another partnership or includes a partner that is a partnership. The profits and losses of the reporting partnership must be calculated on four different bases, unless the members of the other partnership are individually named (which may be administratively impossible in a large multinational firm).

The amounts shown in the reporting partnership's statement as allocated to the other partnership must be calculated on the assumptions that the other partnership is a:

- UK-resident individual;
- Non-UK resident individual;
- UK-resident company; and
- Non-UK resident company.

The CIOT have commented, that, 'while often there is little or no difference in the calculation of profits under the various bases, in some cases there will be and, even if this measure is not as onerous as we think it will be, it will give rise to more work for some nominated partners'.

Overseas partners in investment partnerships

Part 4 of Sch 6 FA 2018 arises from suggestions that have been made to simplify the return requirements of investment partnerships where there is no UK tax at stake. While the Government expect investment partnerships to continue to submit normal partnership returns as before, FA 2018 does provide that, for returns made after the date of Royal Assent, no unique taxpayer reference needs to be included for non-UK resident partners as long as certain conditions set out in new S12ABZA TMA 1970 (as inserted by Para 8(3) Sch 6 FA 2018) are met.

This is a welcome relaxation.

Returns conclusive as to shares of profits and losses

Various cases over recent years have demonstrated how difficult it can be for an individual who is a partner in a partnership to comply with his personal tax obligations to submit a return that is correct to the best of his knowledge and belief where he disagrees with the information included in the partnership return. Hitherto, tax law has required that a partner should include, in his personal tax return, the amount shown as allocated to him in the partnership return. But how can an individual do this and sign off his return as 'correct' when he disputes the allocation of partnership profits in the partnership return?

It is understandable that HMRC are not overly enthusiastic when individual partners challenge the reporting of profit shares allocated to them by a partnership. In this context, the First-Tier Tribunal decision in *King v HMRC* (2016) – where the partners were successful in their appeal – is well worth a read. The judge in this case also makes the point that, where tax legislation is unclear, the Courts will seek to establish the ultimate purpose behind the statutory provisions.

The amendments made by Part 5 of Sch 6 FA 2018 will indeed provide more certainty in cases of dispute, for returns relating to 2018/19 and later tax years, but they will also make the challenging of profit allocations harder for individual partners – see new S12ABZB TMA 1970 (as inserted by Para 10(2) Sch 6 FA 2018), which introduces a special Tribunal procedure for the resolution of disagreements, as evidence of this.

For example, if a partner takes issue with the partnership return, it is unclear exactly what he should do until the matter is resolved. S12ABZB(1) TMA 1970 provides that the partnership return is ‘conclusive’. So this seems to mean that a partner must include in his personal tax return the amount allocated to him in the partnership return until such time as the dispute over that particular allocation is settled. This will be the position in spite of the fact that, in the individual’s view, his personal tax return will not be ‘correct’. In addition, a challenge to the allocation of profits (or losses) has to be made through the Tribunal and so there must be a successful outcome here before the partner’s personal tax return can be ‘corrected’. This suggests that the partner may initially have to pay too much tax before trying to reclaim the overpayment. The CIOT neatly sum up the impact of S12ABZB TMA 1970 with these words:

‘In our view, this does not seem to reflect the relative “power” of the individuals – everything will be in favour of the partnership and HMRC rather than the hard-done-by partner.’

Another point is that the new legislation does not extend to a dispute about the quantum (before any allocation) of the partnership’s profits. This was of course the subject of the dispute in *King v HMRC* (2016). As the rules stand, it is only the allocation of profits that can be challenged under FA 2018. This means that, if a partner disputes the basic analysis as to whether a particular amount forms part of the firm’s taxable profits, he would not have any recourse under this legislation. Would not some sort of appeal procedure make sense in these circumstances?

Finally, a partnership return that has been the subject of a Tribunal referral may not be the subject of another referral (unless it is the first one after the return has been amended). As the CIOT say:

‘We do not understand why, if one partner has made a referral, no other partner should be able to make a referral, even on an unrelated matter.’

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