
Corporate

Office of Tax Simplification

Review of partnerships:
interim report
(published January 2014)

Introduction

1. The Institute of Financial Accountants (IFA) and the Federation of Tax Advisers (FTA) welcome the opportunity to comment on the Office of Tax Simplification (OTS) interim report on partnership tax published on 22 January 2014.
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 IFA and the FTA is given below.

Who we are

4. The IFA is an internationally recognised professional accountancy membership body whose members work for small and medium-sized enterprises (SMEs) or who run or work in small and medium-sized accounting practices (SMPs) that advise SMEs.
5. At the IFA, we put small and medium enterprises (SMEs) first, recognizing their role as vital wealth-creators, as employers to more than half of the UK's private sector workforce and as the power behind vibrant urban and rural communities. We hold the interests of small and medium practices (SMPs) in the accounting profession in equal regard.
6. The FTA is the Tax Faculty of the IFA and is the modern membership body for agents who provide tax compliance and planning expertise to SMEs and entrepreneurs. It is the tax representative for IFA and FTA members.
7. We are proud of our unique relationship with our members, who predominantly come from a SME/SMP background. As a professional accountancy body, we aim to provide the very best support and guidance to our members who operate within this arena, frequently tailoring policies and recommendations to meet the unique challenges and trading relationships associated with smaller business.
8. Founded in 1916, the IFA supports over 10,000 members and students in more than 80 countries with a programme of professional qualifications and education. As well as resources, events, training and seminars. IFA members uphold high standards of conduct, confidentiality and ethics and undertake annual continuing professional development (CPD) activities.
9. The IFA is a full member of the International Federation of Accountants (IFAC), the global body for the accountancy profession. As such, the IFA takes its place alongside the UK and Ireland's six chartered accountancy bodies, as well as 135 national and regional accountancy organisations representing 125 countries and jurisdictions.
10. The IFA is formally recognised as an awarding organisation by Ofqual, the public body responsible for monitoring standards, exams and qualifications (other than degrees) in England, underlining the quality of the IFA's work and the integrity of its qualifications; and is authorised by HM Treasury for Anti Money Laundering supervision.

General Comments

11. Thank you for the opportunity to respond on the OTS interim report on the review of partnerships.
12. We agree with the OTS findings that small and medium sized partnerships find the current tax system difficult to understand and that the compliance burden on these firms is unduly onerous. Consequently measures should be introduced to simplify the taxation of these partnerships and to align the compliance reporting with how the partnership is run.
13. However, even larger partnerships would benefit from a degree of simplification and taxation on a basis that better reflects the increased use of partnerships in modern business.
14. Our proposals are therefore structured around a two-tier hierarchy of partnerships, ie those with turnover of up to £250,000 and no more than 10 members ('smaller partnerships') all of whom are individuals; and those that exceed these thresholds ('larger partnerships'). However, given our membership, our comments focus on the possible areas for simplification in the tax treatment and administration of smaller partnerships.

Our comments on the short and longer term solutions raised in the report are set out below:

Short-term solutions

15. We agree with OTS's suggestions that HMRC:
 - Publishes a manual consolidating all partnership guidance;
 - Develops free software for small partnerships to file online. This should be an integrated solution so that, for an LLP, it can be used to produce both the partnership return for tax purposes and for filing with Companies House; and
 - Republishes the BIS updated 'model partnership agreement' for partnerships to use.
16. We would also support the creation of a HMRC dedicated 'partnership' team with responsibility for providing guidance to and overseeing the tax affairs of smaller partnerships. This team could operate a telephone hot line for those responsible for smaller partnership tax affairs.
17. The interim report identifies that where members of smaller partnerships use tax advisers, members will often have different advisers from each other and from the partnership itself. Consequently in order to streamline the process of reporting partners profit allocations on members individual tax returns based on the partnership adjusted taxable profits, it is proposed that the partnership return is amended so that instead of two members' allocations being shown to a page, each partner's share of the results is shown on a separate page. Each member's page could then be provided directly to the member or his adviser so that they could prepare their self-assessment return.
18. We agree with OTS findings that the penalty regime for partnerships is unduly harsh, for example the raising of late filing penalties on each of the members of a partnership. A possible simplification that should be considered further is for only one penalty to be assessed on the partnership, care of the managing partner.

Longer-term solutions

19. We do not believe that developing a default partnership agreement, based on the 1890 Act or newly developed, should be a high priority of HMRC as there are other simplifications which should be addressed first. Only after the other measures have become established will it become clear whether a default partnership agreement is required.
20. We agree with the findings of the OTS, documented in the report that a consolidated new 'Partnerships Tax Act' is not needed and could result in duplication and an even longer tax code. However, several areas of existing legislation require updating to reflect commercial practice and should be in the main body of legislation, for example SP D12.

Partnership return

21. We understand HMRC's concern that if partnerships are not required to submit returns that they may not be able to trace partnership profits to individual members' tax returns. However, we also recognise the additional burden partnership returns place on smaller partnerships. Consequently we propose that:
 - Smaller partnerships (as defined above), only be required to file a 'Small Partnership Return'. The information contained in the return would be limited to the names and UTRs of members and their date of being admitted to and leaving the partnership.
 - Larger partnerships would continue to file partnership returns as normal since preparation of the partnership return is, as noted in the report, a necessary process to calculate and apportion the business income and hence does not represent an additional burden on the business.
22. It should be possible to complete and submit all forms on-line.

Partnership taxation

23. Following on from the solutions offered in the report, we set out below our recommendations on how partnership taxation can be simplified:

Smaller partnerships

24. The use of the 'cash basis' of taxation represents a significant simplification in the administrative burden placed on small partnerships. However, we believe the threshold for use of the cash basis should be extended to include all 'smaller partnerships' as defined above, ie partnerships with turnover up to £250,000 and with no more than 10 members all of whom are individuals.

Larger partnerships and small partnerships by election

25. In s 3.46 of the report, the possibility of introducing a 'partnership tax' is raised. In our opinion this should be seriously considered at this stage and not deferred to an unknown future date. Of all the proposals raised in the report, our preferred framework for the taxation of larger partnerships is as follows:
 - I. A flat rate of 20% paid on the net profits of the partnership calculated on a fiscal year basis and the opening and closing year rules would be maintained.
 - II. 'Partnership tax' would be payable on 31 January following the end of the tax year. This would also be the filing date for the partnership tax return.
 - III. Taxable profits would continue to be calculated under existing legislation, with the exception of partners expenses which we agree with the OTS should be deductible against a member's profit allocation in the self-assessment return. All members (including members of mixed partnerships) should also be able to use the fixed rate deductions set out in chapter 5A, ITTOIA 05.

- IV. Amounts paid to non-equity partners would be tax deductible for the partnership when calculating the profits on which 'partnership tax' is paid. These amounts would be subject to tax and NICs under PAYE.
 - V. Members would pay income tax on their drawings from the partnership in a tax year. A tax credit would be available for the tax paid by the partnership on the drawings. Class 4 NICs would also be payable on the drawings.
- 26. The advantage of this basis of taxation is that it would allow larger partnerships to retain profits in the partnership to fund working capital or expansion. It would also reduce the requirement for corporate members of partnerships and the artificial distinction between the taxation of small companies and partnerships.
 - 27. In line with one of the OTS suggestions, relief for overlap profits should be given as a deduction from taxable profits over a five year period.
 - 28. A statutory definition of 'drawings' would be required to include benefits received from the partnership.
 - 29. It would also be necessary to introduce anti-avoidance legislation akin to s.455 CTA 2010 to tax partnership loans, as otherwise these could be used to circumvent income tax and NICs on drawings.
 - 30. A repayment mechanism would also need to be introduced if members' drawings exceeded partnership profits for a year and therefore had to be repaid.
 - 31. Given that the taxation of larger partnerships, would in many respects, reflect that for companies in the longer term, consideration could be given to the introduction of reliefs that are currently only available to corporates, such as enhanced research and development tax deductions.

Other points

- 32. Finally, we agree that the SDLT for partnerships needs to be simplified. Our proposal would be to replace schedule 15, FA 2003 with provisions that mirror the capital gains tax treatment of properties by partnerships.
- 33. No disposal would occur for SDLT purposes unless consideration passed between the partners or a revaluation of the property in the partnership accounts followed by a change in partnership sharing ratio.
- 34. The result would be a simpler and fairer approach with a uniform basis of taxation for SDLT and capital gains tax.

Conclusion

- 35. To conclude, we support the OTS recommendation that a simplified regime for the taxation of partnerships is introduced.
- 36. Our proposal of a two-tier hierarchy takes into account the differing level of sophistication of partnerships focuses on reducing the complexities and compliance burden on smaller partnerships in particular.
- 37. Smaller partnerships will enjoy the benefits of the tax basis of taxation that are currently only available to sole traders and thereby remove an artificial distinction in the taxation of small family run businesses.
- 38. Meanwhile the introduction of a 20% flat rate partnership tax for larger partnerships creates a more modern basis of taxing partnerships and moves away from the presumption that partnership profits are available for the partners to draw down and therefore should be subject to income tax.

Should you wish to discuss our responses further, please contact AdamL@ifa.org.uk in the first instance.