

Partnership expenses update

OMB

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Update on partnership expenses and HMRC's guidance.

In February a volunteer on the CIOT's OMB sub-committee raised concerns with HMRC that HMRC had quietly changed its practice regarding the deductibility of business expenses incurred by partners, as distinct from the partnership itself. HMRC has since helpfully clarified its position to that volunteer and we are pleased to be able to share this information with members.

It has been HMRC's longstanding practice to accept that such expenses are deductible for tax purposes if they are incurred wholly and exclusively for the purposes of the partnership trade and are not otherwise disallowed by the usual tax rules. Where the costs are not expensed in the partnership accounts, relief can be claimed by making appropriate adjustments in the partnership's tax returns.

Following the Court of Appeal ruling in the case of *Vaines v HMRC* [2018] EWCA Civ 45, HMRC updated its guidance in its Business Income Manual (at BIM82075 onwards) with the intention of confirming the position in respect of partner expenses in accordance with that decision. However, the revised guidance led many readers to perceive that there had been a change to the longstanding practice, meaning that expenses not included in the partnership's accounts would no longer be allowed for tax purposes in any circumstance.

This was not, of course, why Mr Vaines' argument ultimately failed. Rather, it was concluded that the expense was not incurred wholly and exclusively for the trade of the partnership of which Mr Vaines was, at that time, a partner and there was no statutory basis for claiming tax relief through an adjustment to Mr Vaines' personal tax return. Henderson LJ's obiter dicta suggested that 'there may be a small element of concessionary treatment' to HMRC's practice of allowing tax adjustments through the partnership return for properly deductible expenses incurred by partners personally. However, there was no suggestion that such expenses should not be

allowed.

HMRC listened to feedback and made [further updates to its guidance](#) to confirm its position in BIM 82080 as follows:

‘To be allowable as a deduction for tax purposes, the expense has to be an expense incurred (typically, paid) by the partnership, for the purpose of the trade or property business carried on by the partnership or LLP, and meet the normal tests for being allowable for tax purposes. Ordinarily, a partnership expense will be paid directly from partnership funds. The starting point when a partner pays something on behalf of the partnership, is they will normally then be reimbursed by the partnership from partnership funds.

The partner cannot claim the expense against their share of the profits in their individual return. A key point is that as an expense of the business carried on in partnership, the expense will normally be included in the accounts of the partnership (where the partnership prepares accounts) and deducted in arriving at the commercial profits of the partnership, but provided the expense otherwise meets the wholly and exclusively test (and any other relevant criteria), a deduction may be allowed through the partnership return.’

Although HMRC’s preference is for all expenses of the partnership business to be included in the partnership accounts, it is accepted that this may not always be practical and deductions may still be allowed through the partnership return provided the costs meet the usual deductibility criteria.