

Updated practice

OMB

Personal tax



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Andy Richens probes a little-known area of the tax system

Key Points

What is the issue?

The OTS review of partnerships identified the CGT 'rules' as needing revision – and that knowledge of the rules among those involved was patchy

What does it mean to me?

Advisers who deal with partnerships need to be aware of the governing statement – and that it has been revised

What can I take away?

Although having a significant area of the tax system governed by an SP is in principle unsatisfactory, SP D12 has worked. The refurbished version now reflects the current environment

In March 2013 the government asked the Office of Tax Simplification (OTS) to review the taxation of partnerships. As part of its research, the OTS held about 50 meetings with businesses, advisers and representative bodies, as well as HMRC teams. The interim report, published in January 2014, identified several short-term fixes, medium-term recommendations and longer-term areas for investigation.

After a further 'call for evidence paper' and more meetings, a final report was published in January 2015, covering:

- **education and support for smaller partnerships** – the need for clear and comprehensive guidance at the point of registration;
- **partners' expenses** – a proposal to allow partners to claim their allowable expenses incurred from their share of the profits if the partnership agreement is set out on this basis;
- **international areas** – various technical points were raised;
- **gift aid** – a recommendation for two alternative routes: the firm to make the donation with the representative partner making the gift aid declaration (curiously, in line with current HMRC guidance but out of step with the legislation); or the firm taking a deduction in its computation of trading profits; and
- **capital gains tax** – a review of Statement of Practice D12 (SP D12).

Progress of the final partnership recommendations has been disappointing in many areas, though a sub-group of international specialists from the OTS consultative

committee has progressed some issues with HMRC. One creditable exception has been the way recommendations on capital gains tax (CGT) have been taken forward.

Partnerships and capital gains

Legislation is somewhat lacking in the area of partnership CGT. At present there is TCGA 1992 s 59 which briefly states: 'Tax in respect of chargeable gains accruing to them [ie partners] on the disposal of any partnership assets shall ... be assessed and charged on them separately.'

In 2001, s 59 was supplemented by s 59A, which was introduced to apply CGT to members of limited liability partnerships (LLPs). In essence, it parallels s 59 unless the LLP ceases to carry on a trade or business when it would itself be chargeable to tax on gains arising as if it were a company.

With such limited legislation, in order to set down an agreed practice in dealing with capital gains tax on partnership assets, a SP D12 was introduced by the Commissioners of Inland Revenue, as they were in January 1975, after talks with the Law Society and allied accountancy bodies.

SP D12 has remained in place and largely unchanged since. Some amendments have been made to cover lump sums and annuities on retirement, indexation allowance, rebasing elections (now redundant) and finally *Revenue & Customs Brief 3/08* on contributions of capital in specie, more of which later.

The OTS review

At first glance, it may appear extraordinary that such an important area of taxation is governed almost entirely by an HMRC statement of practice from 40 years ago.

We were told of some disagreements over the interpretation of the statement but the view of those who had dealt with it was that the statement worked in practice. Interestingly, there seemed to be a marked reluctance to push issues to litigation: we heard a number of times that the flexibility offered by a Statement of Practice (SP) coupled with the uncertainty of the core legislation encouraged parties to resolve disputes. This has made the OTS wonder whether the SP approach could work elsewhere in the tax code.

We did explore how the SP might be turned into legislation: the estimate was some 50 pages of complex law. This was unpalatable to most – in the words of one, ‘if it ain’t broke, don’t fix it’.

The conclusion in the OTS final report supported this view. Although having the rules in legislation was preferable in principle, in practice keeping the rules in an SP was simpler. We therefore recommended HMRC produce a revised and updated version of SP D12.

A key issue was whether the SP would need to be withdrawn under the programme of reviewing extra statutory concessions as a result of the decision in *Inland Revenue ex p Wilkinson* [2005] UKHL 30. Research by HMRC and the OTS drove them to the conclusion that this was not the case because the statement represented interpretation of the underlying legislation. The OTS report noted several issues that needed attention:

There had been widespread misunderstanding on whether paragraph 4 (change in profit share ratios) of SP D12 applied if assets were contributed to the partnership by way of a capital contribution. *Revenue & Customs Brief 03/08* acknowledged that HMRC officers may have erroneously applied paragraph 4 more widely than was justified if an asset was contributed to a partnership, adding to the misunderstanding. The correct treatment was set out in the *Brief*, but no change to SP D12 had been made. Although the change may have bedded in with some of the tax profession, we felt that the statement needed to cover this point.

- The statement ought to include links to appropriate manual guidance and examples (the new consolidated partnership manual was introduced after an early recommendation from the OTS) and, in turn, the manuals to include links to HMRC help sheets.
- The term ‘asset surpluses’ in paragraph 4 required updating, and in general the large paragraphs of text needed breaking down into a more modern style.
- When SP D12 was originally drafted, most partnerships were professional arrangements, and money rarely changed hands on entering or leaving. The practice had become more widespread, and we recommended clarification of paragraph 6 of the statement.
- The statement was silent on whether holdover relief may be claimed when a charge to CGT arises, and the OTS recommended including such a reference.
- The statement included references to taper relief that were no longer valid.

Perhaps most worrying of all was evidence that many smaller advisers, and the businesses themselves, were unaware of the way in which capital gains were taxed, or even the existence of SP D12. This may be inevitable to a degree, given that partnership capital gains are infrequent. Such businesses tend to hold few capital assets and gains will typically arise only on their disposal of to an external third party or on total sale of the business. Awareness clearly needs to be improved and so a concluding recommendation was that the launch of a new statement should be publicised to help raise awareness.

The new SP D12

HMRC agreed to produce a revised draft for review by the OTS and members of the sub-committee who had worked on the partnership project. In turn, the sub-group raised further suggestions including the deletion of the reference to the March 1982 election (regarding the so-called 'kink test'), and the inclusion of a new paragraph on entrepreneurs' relief, rollover relief and business asset gift relief. An agreed revised and updated statement was then produced. It was also agreed that the statement would remain 'light touch', with technical guidance on areas such as entitlement to entrepreneurs' relief set out in the consolidated HMRC partnership manual. In line with the recommendations, links to the partnership manual are given throughout the statement.

The revised SP D12 was published on 14 September 2015 and the OTS sub-committee agrees that it represents a considerable improvement on the original draft. It has also proved that a joint approach with HMRC on the redrafting of a statement of practice can work well in reaching a successful outcome. Anyone who deals with partnerships should read it.

Further Information

Read the revised SP D12 [here](#).