

FINANCE ACT 2014

EXPLANATORY NOTES

INTRODUCTION

Section 74 and Schedule 17: Partnerships (Part 2): Partnerships With Mixed Membership

Summary

1. This section and Schedule counter tax advantages arising to individuals in partnership with persons who are not individuals (mixed membership partnerships) by way of excess allocations of profits or losses to certain members.

Details of the Schedule

2. Paragraph 7(3) inserts new sections 850C to 850E into Part 9 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).
3. Subsection (1) of new section 850C provides that the consequences in subsections (4) and (5) apply in the circumstances where an individual (“A”) is a partner in a firm that has a profit for a relevant period of account and a non-individual partner (“B”) has a profit share and either of conditions X or Y is met.
4. Subsections (2) and (3) of new section 850C detail conditions X and Y. Condition X relates to where A’s profit is deferred. Condition Y relates to where A has the power to enjoy B’s profit share.
5. Subsection (4) of new section 850C provides the consequences for A if the circumstances and conditions in subsection (1) are met. It explains how A’s profit share is to be increased by the amount of B’s profit share that can reasonably be supposed to be attributable to A’s deferred profit or A’s power to enjoy B’s profits. The increase in the case of A’s power to enjoy B’s profits is not to be more than the amount by which B’s profit share exceeds B’s appropriate notional profit, less any amount that is attributable to A’s deferred profit. B’s appropriate notional profit is calculated by reference to B’s appropriate notional return on capital (as defined in subsection (11)) and appropriate notional consideration for services (as defined in subsection (15)).
6. Subsection (5) of new section 850C provides the consequences for B if the circumstances and conditions in subsection (1) are met and B is subject to income tax. In determining B’s profit for a period of account adjustments are to be made to reflect the increase in A’s profit share on a just and reasonable basis.
7. Subsection (6) of new section 850C defines an “individual partner” and “non-individual partner”. A “non-individual” would include, for example, a company or an individual acting as a trustee. It does not include the firm itself where it is treated as a partner under new section 863I (allocation of profit to AIFM firm).
8. Subsection (7) of new section 850C specifies that B’s profit share is to be determined by reference to the income tax rules for calculating a partner’s profit share. This is the case whether B is chargeable to income tax or corporation tax.

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9. Subsection (8) of new section 850C defines the term “A’s deferred profit” used in condition X.
10. Subsection (9) of new section 850C defines the term “the relevant tax amount” used in conditions X and Y.
11. Subsection (10) of new section 850C defines the term “the appropriate notional profit” used in condition Y as the sum of the appropriate notional return on capital and the appropriate notional consideration for services.
12. Subsections (11) and (12) of new section 850C define the term “the appropriate notional return on capital” used in subsection 10 and specify how it is to be calculated by reference to B’s contribution to the firm.
13. Subsections (13) and (14) of new section 850C specify how the amount of B’s contribution to the firm for the purposes of subsections (11) and (12) is to be determined.
14. Subsections (15) to (17) of new section 850C define the term “the appropriate notional consideration for services” used in subsection 10 and specify how it is to be calculated.
15. Subsection (18) of new section 850C details the circumstances in which A has the power to enjoy B’s profit share. This is the case if A is a connected person in relation to B other than being connected by reason of being partners in the partnership, or if A is party to arrangements with a main purpose of securing that an amount included in B’s profit share is charged to corporation tax rather than income tax or is otherwise subject to corporation tax rules rather than income tax rules, or if any of the enjoyment conditions specified in subsection (20) are met in relation to all or part of B’s profit share.
16. Subsection (19) of new section 850C defines the term “arrangements”.
17. Subsections (20) and (21) of new section 850C detail the enjoyment conditions including making clear that references to A include any person connected with A apart from B.
18. Subsections (22) and (23) of new section 850C apply where all or part of the increase in A’s profit share is allocated by A to the firm under new section 863I of ITTOIA 2005, which modifies the rules for the taxation of partnerships that manage alternative investment funds, and B makes a payment representing income tax to the firm. For income tax purposes, the payment is not to be treated as income of any partner in the firm or to be taken into account in calculating any profits or losses of B or otherwise deducted from any income of B.
19. Subsection (1) of new section 850D provides that the consequences in subsections (4) and (5) apply in the circumstances where a non-individual partner (“B”) has a profit share for a relevant period of account, and individual (“A”) personally performs services for the firm, it is reasonable to suppose that A would have been a partner in the firm but for the rules in new section 850C and either of conditions X or Y is met.
20. Subsections (2) and (3) of new section 850D set out conditions X and Y. Condition X relates to amounts representing A’s deferred profit in B’s profit share. Condition Y relates to where A has the power to enjoy B’s profit share.
21. Subsection (4) of new section 850D provides the consequences for A if the circumstances and conditions in subsection (1) are met. A is treated as a partner in the firm for the relevant period of account, except for the purposes of new section 863I of ITTOIA 2005, and as having a share of the firm’s profit for the relevant period of account which is chargeable to income tax. A’s share of the profit is the amount of B’s profit that can reasonably be supposed to be attributable to A’s deferred profit or A’s power to enjoy B’s profits. A’s share of the profits is not to be more than the amount by which B’s profit share exceeds B’s appropriate notional profit, less any amount that is attributable to A’s deferred profit. B’s appropriate notional profit is determined in the same way as in new section 850C of ITTOIA 2005.

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22. Subsections (5) and (6) of new section 850D provides the consequences for B if the circumstances and conditions in subsection (1) are met and B is subject to income tax. In determining B's profit share for a period of account adjustments are to be made to reflect A's share of the firm's profit on a just and reasonable basis.
23. Subsection (7) of new section 850D specifies that B's profit share is to be determined by reference to the income tax rules for calculating a partner's profit share. This is the case whether B is chargeable to income tax or corporation tax.
24. Subsection (8) of new section 850D provides an automatic assumption in relation to a member of a partnership which is associated with the firm. The assumption is that it is reasonable to suppose that the member would have been a partner in the firm at a time during the relevant period of account, or an earlier period of account, but for the provision contained in new section 850C of ITTOIA 2005.
25. Subsection (9) of new section 850D provides the circumstances in which a partnership is "associated" with the firm.
26. Subsections (10) to (13) of new section 850D provides definition and interpretation of the terms used in new section 850D: "partnership", "A's deferred profit", "the appropriate notional profit" and "A's power of enjoy B's profit share".
27. Subsection (1) of new section 850E applies subsection (2) if new section 850C(4) of ITTOIA 2005 applies to increase A's profit share, or new section 850D(4) of ITTOIA 2005 applies to treat A as having a share of the firm's profit, and as a result of an agreement in relation to the excess of B's profit share, B makes payment to another person out of the excess part of B's profit share and the payment is not made with a main purpose of obtaining a tax advantage. The "excess part of B's profit share" is the amount of B's profit share that represents the amount of the increase in A's profit share under new section 850C(4) or A's share of the firm's profit under new section 850D(4).
28. Subsection (2) of new section 850E provides that, for income tax purposes, the payment is not to be income of the recipient, is not to be taken into account in calculating any profits or losses of B or otherwise deducted from any income of B, and is not to be regarded as a distribution.
29. Subsection (3) of new section 850E provides definitions relevant to subsection (1).
30. Paragraphs 8(1) and 8(2) amend the overview of Chapter 3 of Part 4 of Income Tax Act 2007 (ITA 2007).
31. Paragraph 8(3) inserts new section 116A into Chapter 3 of Part 4 of ITA 2007.
32. Subsections (1) to (5) of new section 116A provide that no relevant loss relief is to be given to an individual for a loss made in a trade or profession as a partner where the individual is party to arrangements with a main purpose of ensuring that losses are allocated, or otherwise arise, to the individual, or individuals, rather than a non-individual, with a view to the individual obtaining relevant loss relief. For the purpose of this section, it does not matter if the entity who is the non-individual is yet to be formed or participate in the partnership.
33. Subsection (6) of new section 116A defines "arrangements" and "relevant loss relief" for the purposes of this section.
34. Paragraphs 9(1) and 9(2) amend the overview in Chapter 4 of Part 4 of ITA 2007.
35. Paragraph 9(3) inserts new section 127C into Chapter 4 of Part 4 of ITA 2007.
36. Subsections (1) to (5) of new section 127C provide that no relevant loss relief is to be given to an individual for a loss made in a property business as a partner where the individual is party to arrangements with a main purpose of ensuring that losses are allocated, or otherwise arise, to the individual, or individuals, rather than a non-

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individual, with a view to the individual obtaining relevant loss relief. For the purpose of this section it does not matter if the entity who is the non-individual is yet to be formed or participate in the partnership.

37. Subsection (6) of new section 127C defines “arrangements” and “relevant loss relief” for the purposes of this section.
38. Paragraphs 10(1) and 10(2) amend Part 17 of the Corporation Tax Act 2009 (CTA 2009).
39. Paragraph 10(3) inserts new section 1264A into Part 17 of CTA 2009.
40. Subsections (1) and (2) of new section 1264A provide for the situation where the income tax provisions in new sections 850C(4) or 850D(4) of ITTOIA 2005 apply to increase individual A’s profit share, or to treat A as having a share of the firm’s profit, and a company is non-individual B in relation to A. In determining the company’s profits from the firm for an accounting period, adjustments are to be made to reflect the increase in A’s profit share, or the amount of profit treated as A’s share of the firm’s profit, on a just and reasonable basis.
41. Subsection (3) of new section 1264A makes corresponding provision for corporation tax in respect of sections 850C(23) and section 850E(2) of ITTOIA 2005.
42. Paragraphs 11 to 14 provide commencement rules. The changes will take effect from 6 April 2014 with the exception of anti-avoidance rules concerning tax-motivated profit allocations. These rules came into force on 5 December 2013 in order to protect against risks to tax revenue.

Background Note

43. This change is part of a wider review of certain parts of the partnership rules announced in Budget 2013.
44. A consultation document, *Partnerships: A review of two aspects of the tax rules*, was published on the [GOV.UK](http://www.gov.uk) website on 20 May 2013 and the consultation closed on 9 August 2013.
45. This element of the partnerships review measure is discussed in the consultation document under the headings: *Partnerships with mixed membership – profits and Partnerships with mixed membership - losses*.