

**1 UK residents and foreign partnerships**

- (1) In section 115 of ICTA (partnerships involving companies: supplementary), after subsection (5B) insert—
  - “(5C) For the purposes of subsections (5) to (5B) the members of a partnership include any company which is entitled to a share of income or capital gains of the partnership.”
- (2) In section 59 of TCGA 1992 (partnerships) insert at the end—
  - “(4) For the purposes of subsections (2) and (3) the members of a partnership include any person entitled to a share of capital gains of the partnership.”
- (3) In section 858 of ITTOIA 2005 (resident partners and double taxation agreements) insert at the end—
  - “(4) For the purposes of this section, the members of a firm include any person entitled to a share of income of the firm.”
- (4) The amendments made by subsections (1) to (3) are to be treated as always having had effect.
- (5) For the purposes of the predecessor provisions, the members of a partnership are to be treated as having included, at all times to which those provisions applied, a person entitled to a share of income or capital gains of the partnership.
- (6) “The predecessor provisions” means—
  - (a) section 153(4) and (5) of the Income and Corporation Taxes Act 1970 (c. 10) (as it had effect under section 62(2) of F(No. 2)A 1987), and
  - (b) sections 112(4) to (6) and 115(5) of ICTA.

## EXPLANATORY NOTE

### CLAUSE [XX]: DOUBLE TAXATION TREATY ABUSE

#### SUMMARY

1. Clause [XX] amends section 115 of the Income and Corporation Taxes Act 1988 (ICTA), section 59 of the Taxation of Chargeable Gains Act 1992 (TCGA) and section 858 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) which provide that, where UK residents are members of foreign partnerships nothing in any Double Taxation Treaty affects their liability to corporation tax, capital gains tax or income tax respectively. The clause puts it beyond doubt that persons entitled to share in the profits of a partnership are members of that partnership.

#### DETAILS OF THE CLAUSE

2. Subsection (1) inserts a new subsection (5C) in section 115 of ICTA (which provides the rules for taxing companies that are members of partnerships).
  - Subsection (5C) provides that, for the purposes of subsections (5) to (5B), a member of a foreign partnership includes any company which is entitled to a share of income or capital gains of the partnership.

3. Subsection (2) inserts a new subsection (4) in section 59 of TCGA (which provides the rules for taxing persons other than companies who are members of a partnership on gains from partnership assets):
  - Subsection (4) provides that, for the purposes of subsections (2) and (3), a member of a foreign partnership includes any person entitled to a share of capital gains of the partnership.
4. Subsection (3) inserts a new subsection (4) in section 858 of ITTOIA (which confirms that UK individuals who are members of foreign partnerships are taxable on their profits therefrom):
  - Subsection (4) provides that, for the purposes of section 858, a member of a foreign partnership includes any person entitled to a share of income of the partnership.
5. Subsection (4) confirms that subsections (1) – (3) are merely clarifications of the relevant parts of section 115 of ICTA, section 59 of TCGA and section 858 of ITTOIA and are to be treated as always having had effect.
6. Subsection (5) carries the effect of subsections (1) – (3) back to the provisions that preceded the relevant parts of section 115 of ICTA, section 59 of TCGA and section 858 of ITTOIA.

7. Subsection (6) sets out the relevant predecessor provisions.

### **BACKGROUND NOTE**

8. An avoidance scheme purports to exempt from UK tax income received by UK resident individuals by using certain provisions in the UK's bilateral Double Taxation Treaties.
9. This scheme involves the establishment of offshore trusts, (of which the UK individuals are both settlors and beneficiaries) and partnerships (of which the foreign trustees of those trusts are partners).
10. The partnerships acquire the rights to receive the UK individuals' income but the terms of the trusts are such that, as beneficiaries of the trust, the UK individuals retain beneficial entitlement to the income - with the trustees obliged to remit the income to the UK individuals as it arises.
11. The users of the scheme claim that, under the terms of the relevant Double Taxation Treaty, the UK is not entitled to tax the partnership income of the foreign trustees. As that income is precisely the same income as that received by the UK individuals as beneficiaries of the trust, they argue that the UK is not entitled to tax the UK individuals on it.

12. Legislation was introduced in Finance (No 2) Act 1987, which provided that (as had almost universally been assumed to be the case until a High Court decision to the contrary,) a Double Taxation Treaty did not affect UK residents' liability to UK tax on their share of income or gains from a foreign partnership. This new avoidance scheme purports to get round that legislation by claiming that the foreign trustees are the partners rather than the UK individuals.
  
13. The Government believes that a partner for the purposes of that legislation has always included all those persons entitled to a share of income or capital gains of the partnership. As such, the UK individuals remain liable to UK tax despite the elaborate, artificial structure designed to exempt them. This clause will put it beyond doubt that the legislation has always had that effect.

## 1 UK residents and foreign enterprises

- (1) After section 815A of ICTA insert—

### “815AZA UK residents and foreign enterprises

- (1) Where arrangements having effect under section 788 make the provision mentioned in subsection (2) (however expressed), that provision does not prevent income of a person resident in the United Kingdom being chargeable to income tax or corporation tax.
  - (2) The provision is that the profits of an enterprise which is resident outside the United Kingdom, or carries on a trade, profession or business the control or management of which is situated outside the United Kingdom, are not to be subject to United Kingdom tax except in so far as they are attributable to a permanent establishment of the enterprise in the United Kingdom.
  - (3) A person is resident in the United Kingdom for the purposes of this section if the person is so resident for the purposes of the arrangements having effect under section 788.
  - (4) This section does not apply in relation to—
    - (a) income of a company resident in the United Kingdom to which section 115(5A) applies, or
    - (b) income of a person resident in the United Kingdom to which section 858 of ITTOIA 2005 applies.”
- (2) The amendment made by subsection (1) has effect in relation to income arising on or after 12 March 2008.

**EXPLANATORY NOTE****CLAUSE [XX]: DOUBLE TAXATION TREATY ABUSE****SUMMARY**

1. Clause [XX] amends section 788 of the Income and Corporation Taxes Act 1988 (ICTA) which provides the statutory basis for the application of the UK's Double Taxation Treaties. This clause will ensure that a specific provision commonly found in those treaties (that is designed largely to limit the rights of the parties to tax the business profits of residents of the other State) cannot be read as preventing the income of UK residents being charged to UK tax.

**DETAILS OF THE CLAUSE**

2. Subsection (1) inserts a new section 815AZA after section 815A of ICTA.
  - Subsection (1) of new section 815AZA provides that the provision in Double Taxation Treaties mentioned in subsection (2) does not (however expressed) prevent the income of a UK resident person being chargeable to income tax or corporation tax.

- Subsection (2) provides that the provision referred to in subsection (1) establishes that the trading profits of a non-resident enterprise are taxable in the UK only to the extent that they are attributable to a business carried on through a permanent establishment in the UK.
  - Subsection (3) provides that a UK resident for the purposes of this section is one that is so resident for the purposes of a double taxation treaty.
  - Subsection (4) provides that the section is not to apply where section 115(5A) of ICTA or section 858 of the Income tax (Trading and Other Income) Act 2005 (ITTOIA) applies.
3. Subsection (3) provides that these provisions will apply to income arising on or after 12 March 2008

### **BACKGROUND NOTE**

4. Part of the purpose of Double Taxation Treaties is to ensure that those who carry on business in more than one country are taxed only once on their income.
5. One provision commonly found in the UK's Double Taxation Treaties is designed to ensure that UK persons carrying on business overseas are taxed overseas only to the extent of the activities carried on

there. The provision is usually reciprocal such that foreigners carrying on business in the UK are taxed in the UK only to the extent of the activities carried on in the UK.

6. The purpose of this clause is to ensure that this provision` cannot be misused by UK residents to avoid UK tax in the way that some UK residents have attempted to do through the use of foreign trusts and partnerships. Clause [XX] ensures that the provisions cannot be misused where there is a partnership. This clause will ensure that the provisions cannot be misused in circumstances not involving partnerships.