

Tax avoidance: Chapter [1]: Companies in partnership

Overview

1. These clauses rewrite sections 131 to 133 of FA 2004 (companies in partnership).
2. Sections 131 and 132 of FA 2004 were introduced to counter avoidance schemes entered into by certain companies. Such schemes involved a company being a member of a partnership but not being entitled to a proper measure of the partnership's profits.
3. A simplified example of such an avoidance scheme might have been:
 - A UK resident company (U) entered into a partnership with a non-UK resident company (N).
 - U put £9000 of capital into the partnership whilst N put in £1000 of capital.
 - All of the partnership profits of, say, £1000 income (all foreign sourced) were allocated and paid to N; it was accordingly claimed that none of that income was liable to corporation tax.
 - N then sold its partnership interest to U for, say, £100.
 - This gave U a profit of £900 (£10,000 of partnership capital less its cost to U of £9,100).
 - It was then claimed that U's profit of £900 did not represent income for corporation tax purposes.

If the partnership profits had been allocated in a straightforward manner U would have been entitled to £900 of income which would have been liable to corporation tax.

4. Section 133 of FA 2004 reduces, in certain cases, a company's chargeable gains where income is treated as arising to the company under section 131 of FA 2004.

Clause 1: Charge to tax where return of capital exceeds contribution

5. This clause imposes a charge to corporation tax on income if a company gets back capital from a partnership (or receives consideration for disposing of an interest in the partnership) in the circumstances set out in the clause. It is based on section 131(1), (2), (4) and (10) of FA 2004.

6. *Subsection (3)* uses "post-commencement" where the source legislation uses "relevant" in relation to labels for certain withdrawals or receipts of consideration. The change is designed to give an indication of what it is that makes the withdrawals or receipts relevant in the context.

7. Subsection (3) also uses the label “the company’s investment in the partnership” in place of “the company’s contribution to the partnership” in the source legislation. The new label is considered to be more appropriate because the amount in question may include things that are not in fact contributions by the company to the partnership.

8. *Subsection (5)* uses the label “relevant partnership profits” in place of “relevant profits” in the source legislation. The change is designed to give an indication of what kind of profits are in view.

<p>Q1. We welcome comments on the proposal to use different labels from some of those used in the source legislation.</p>
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Clause 2: The chargeable amount

9. This clause sets out the amount on which a company is chargeable under clause 1. It is based on section 131(2) and (5) to (9) of FA 2004.

10. In simplified terms, two amounts are calculated. The first is broadly the capital profit that the company has realised on its investment in the partnership. The second is broadly the extra amount of partnership profits that would have been allocated to the company if profit sharing had been on the basis of contributions to capital. The lower of these two amounts is treated as income of the company.

11. *Subsections (5) and (6)* modify the clause for cases where partnership profits include amounts that are not of a revenue nature for corporation tax purposes and cases where clause 1 applies more than once to the same company partner.

Clause 3: Interpretation of sections 1 and 2

12. This clause provides definitions and other interpretative provision for clauses 1 and 2. It is based on sections 131(2) and (3) and 132 (3) to (5) of FA 2004.

Clause 4: Supplementary provisions

13. This clause supplements clauses 1 to 3. It is based on section 132(1), (2) and (6) of FA 2004.

Clause 5: Effect on computations for purposes of section 8(1) of TCGA

14. This clause provides for a case in which a company’s chargeable gains may be reduced by reason of income treated as arising to the company under clause 1. It is based on section 133(1) to (4) and (10) of FA 2004.

15. The disposal of an interest in a partnership by a company may give rise to chargeable gains (net of allowable losses) (conditions B and C). It may also give rise to one or more amounts treated as income when the company receives consideration for the disposal of the interest in the partnership (condition A).

16. In such a case, the individual chargeable gains and individual allowable losses in question are ignored. Instead the total of those chargeable gains (less the total of those allowable losses) is treated as if it was a chargeable gain for the accounting

period in which the consideration, for the disposal of the partnership interest, was received (“the net gain”). The net gain is reduced by the chargeable amount (found under clause 2 in relation to the receipt of consideration for the disposal of the partnership interest).

17. This provision, as supplemented by the next four clauses, is intended to reduce the risk of “double taxation” in relation to consideration received for the disposal of a partnership interest.

Clause 6: Application of section 5 if same disposal gives rise to multiple receipts

18. This clause deals with a case where clause 5 applies to the disposal of a partnership interest but the consideration for the disposal consists of more than one receipt. It is based on section 133(6) and (10) of FA 2004.

19. In such a case, the net gain is treated as arising in the accounting period in which the first receipt arises. That net gain may be reduced by the total of the chargeable amounts that arise in relation to the receipts of consideration.

Clause 7: Deductibility of allowable losses if deduction prevented by section 5

20. This clause deals with a case where an allowable loss is unused purely because a chargeable gain has been treated, under clause 5, as not arising (with a net gain treated instead as arising in the accounting period in which the consideration is received). It is based on section 133(7) to (9) of FA 2004.

21. To the extent that the allowable loss has not been used, it is deductible from chargeable gains in the accounting period in which the net gain is treated as arising.

22. But if the allowable loss in question is restricted, because section 18(3) of TCGA (transactions between connected persons) applies to it, there is a limit on the amount of the allowable loss which is deductible in the accounting period in which the net gain is treated as arising. The limit is the amount of the net gain remaining after the reduction in clause 5(8).

Clause 8: Effect on sections 37(1) and 39(1) of TCGA

23. This clause deals with how the computations of chargeable gains and allowable losses are affected by a chargeable amount arising on the disposal of a partnership interest. It is based on section 133(2), (5) and (10) of FA 2004.

24. Sections 37(1) and 39(1) of TCGA provide for exclusions from the consideration for the disposal of an asset, or from sums deductible from such consideration, of amounts which are taken into account in computing income or as a deduction from income.

25. For the purposes of those sections the computation of the chargeable amount is ignored.

Clause 9: Interpretation of sections 5 to 8

26. This clause supplements clauses 5 to 8. It is based on section 133(10) of FA 2004.