The Personal Tax Planning Review

FOREIGN ASPECTS OF PARTNERSHIPS UNDER SELF ASSESSMENT

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Introduction

Self Assessment makes some very fundamental changes to the taxation of partnerships. TA 1988 s.111 used to provide that "where a trade or profession is carried on by two or more persons jointly, income tax in respect thereof shall be computed and stated jointly, and in one sum, and shall be separate and distinct from any other tax chargeable on those persons or any of them, and a joint assessment shall be made in the partnership name". However, FA 1994 s.215(1),(4),(5), as amended by FA 1995 s.117(2), amended TA 1988 s.111 for 1994/95 and subsequent years of assessment in relation to partnerships whose trades, professions or businesses were set up and commenced after 5th April 1994, and for 1997/98 and subsequent years of assessment in relation to partnerships set up and commenced before 6th April 1994. The changes apply from 1995/96 for partnerships which are controlled abroad (FA 1995 s.125(1)). The revised TA 1988 s.111(1) provides that where a trade or profession is carried on by persons in partnership, the partnership shall not, unless the contrary intention appears, be treated for the purposes of the Taxes Acts as an entity which is separate and distinct from those persons.

The main effect of this change is that although the partnership profits will continue to be computed as a single entity, in fact as if they were the profits of an individual resident in the UK (TA 1988 s.111(2)), each partner's share is computed in accordance with the profit sharing arrangements applicable to the accounting period and not by reference to the profit sharing arrangements in the fiscal year (TA 1988 s.111(3)) . Each partner will then self assess on his share of the partnership profits as if that source of income were a deemed sole trade or profession. This means that a partner joining or leaving a partnership is deemed to have commenced or ceased his deemed sole trade and the normal

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commencement provisions under the current year basis of assessment are applied, giving rise to a potential overlap on commencement and overlap relief on cessation by reference to each partner's deemed sole trade (TA 1988 s.111(4)). It also has the effect of removing in most cases the joint and several liability which each partner had, under the old rules, for the partnership tax liabilities.

These rules are, of necessity, modified where there is a change of accounting date of the partnership itself by providing that this will also be treated as a change of accounting date of the individual partners' deemed trades or professions (TA 1988 s.111(4)(c)) and there is no deemed change of accounting date under TA 1988 s.62(2) unless there is a change that would have applied to the partnership itself (TA 1988 s.111(4)(d), (5) and (6)).

Loss relief is dealt with by each partner individually, as if his share of the partnership loss were a loss from a deemed sole trade (TA 1988 s.111(7)). Other income of the partnership, such as interest not subject to deduction of tax at source assessable under Schedule D Case III, income from foreign securities under Schedule D Case IV, foreign possessions under Schedule D Case V, miscellaneous income under Schedule D Case VI and rental income under Schedule A, are all computed under the rules applicable to their respective Schedules and Cases but by reference to basis periods as if it were income of a deemed second trade of each individual partner and then assessable on each individual partner (TA 1988 s.111(8)).

This means that the Schedule D Case I and II rules apply to determine the appropriate basis period and a deemed commencement and cessation on joining or leaving the partnership. It does not convert the other income into trading income if it would not already be so. Taxed income of the partnership is divided among the partners and self-assessable by each of them by reference to the fiscal year not the partnership basis period.

TA 1988 s.111(13) brings into play the overlap provisions on commencement and the overlap relief rules on cessation, and any excess overlap relief is offsetable against each partner's total income under TA 1988 s.111(9).

In order to enable each partner to self assess, new management provisions are introduced to require a nominated partner to submit a partnership return containing details of the whole income of the partnership under TMA 1970 s.12AA and also to provide a partnership statement under TMA 1970 s.12AB allocating the partnership profits among the partners. The income as shown on the partnership statement for each partner must be included in his own personal return and self assessment (TMA 1970 s.8(1B) and (1C)). This also has the effect that where the Revenue exercise their power to enquire into a partnership return under TMA 1970 s.12AC they will automatically be opening an enquiry into each individual partner's personal return as that return will include the share of partnership income as shown by the partnership return and statement.

Overseas income of a UK partnership

Merely because a partnership has overseas activities does not mean that it has overseas income assessable as such under Schedule D Case V, as the income may be assessable as part of the world-wide income of a UK based trade or profession taxable under Schedule D Cases I or II; *London Bank of Mexico v Apthorpe* (1891) 3 TC143 and *Davies v Braithwaite* (1933) 18 TC 198. It really depends on where the control, the head and brain of the enterprise, is located; *Ogilvie v Kitton* (1908) 5 TC 338, *Spears v Mackinnon*, (1929) 14 TC 386, *San Paulo (Brazilian) Railway Co Ltd v Carter* (1895) 3 TC 344, *Denver Hotel Co Ltd v Andrews* (1895) 3 TC 356, *Grove v Elliotts and Parkinson* (1896) 3 TC 481. Wherever there is no control of the trade from the UK, for example where a power of attorney is given to an overseas manager or where the trade is under the control of non-resident partners, it would be regarded as overseas income assessable under Schedule D Case V; *Trustees of Ferguson deceased v Donovan* (1927) 1 ITC 214, *Colquhoun v Brooks* (1889) 2 TC 490.

Whether the income from the foreign activities of a UK partnership is assessed under Schedule D Cases I or II as part of the world-wide income or under Schedule D Case V as income from an overseas trade or profession, is not dependent on whether or not there is a taxable presence in the overseas country. They may well be a foreign tax liability as a result of there being an overseas branch or agency which may be chargeable to foreign tax either on the partnership or on the individual partners. This will depend on the overseas tax rules, and on the business profits and residence provisions of any double taxation agreement. If any foreign tax is payable by reference to the overseas profits, a credit should be available in the UK, either as treaty relief under TA 1988 s.788 or unilateral relief under TA 1988 s.790. The relief would be for the tax charged abroad on the individual partners or on the apportionment of the partnership charge where the partnership itself is assessed to foreign tax, which would be allocated through the partnership statement to the individual partners and claimed in their individual self assessments.

In the transitional year 1996/97 the foreign tax credit, where the averaging basis is applied, is one half of the foreign tax paid in the two years ended 5th April 1997. Where the remittance basis applies, the foreign tax applicable to those remittances is credited in the transitional year as one half of the foreign tax applicable to remittances in 1995/96 and 1996/97, under FA 1994 Schedule 20 para 10(5). Where 1995/96 is computed on the fiscal year basis as opposed to the preceding year basis, so is 1996/97, the full credit for foreign tax is available for both years under FA 1994 Schedule 20 para 10(5A) and FA 1995 s.122(4)(5).

The introduction of self assessment does not affect the rules relating to remittances and constructive remittances. The rules giving full double taxation relief on profits each time they come into an assessment as a result of overlap periods is maintained by appropriate modifications to TA 1988 s.804(1) by FA 1994 s.217, as is the claw back of excess relief under TA 1988 s.804 (5) where overlap relief becomes available under TA 1988 s.63A.

Foreign Trades and Professions

FA 1994 s.207 (2) amended TA 1988 s.65(3) to provide that the Schedule D Case I and II rules should apply to an overseas trade or profession assessed under Schedule D Case V, including the commencement year provisions. In the partnership context, however, the Schedule D Case V income would be that of the partnership accounting period as income of the deemed second trade and allocated among the partners in accordance with the profit sharing ratio for the partnership accounting period. This would apply even where the accounts of the foreign branch or partnership were made up to a different date. For example, if a partner shared in the profits of a foreign partnership which made up its accounts to, say, 31st March 1998, through a UK partnership which made up its accounts to 30th April 1998, which included the profits of the foreign partnership to 31st March 1998, the Schedule D Case V income from the deemed second trade of the partnership would be self assessed by each partner for 1998/99 because the partnership accounting period ends in 1998/99. If, however, the UK resident were a direct partner of an overseas partnership which made up its accounts to 31st March 1998, he would self assess his share of the income from that partnership for 1997/98 computing the profits under Schedule D Case I or II under TA 1988 s.65(3).

Under the old rules, income from a foreign trade or profession should normally have been assessed under Schedule D Case V on the profits of the fiscal year preceding the year of assessment, and the transitional averaging provisions applicable to 1996/97, in FA 1994 Schedule 20 para 6(1),(2A), would be on one half of the aggregate of the income arising in 1996/97 and 1995/96. This also applies to partnership income from an overseas branch or partnership. In practice, however, income was very often assessed for the profits of the accounting period ending in the preceding fiscal year as if it were assessable under Schedule D Case I or II, and in such circumstances it is understood that the Revenue will apply the transitional year averaging provisions as if the income were assessable under Schedule D Case I or II rather than applying the strict fiscal year averaging basis in the transitional period.

Transitional overlap relief is given under FA 1994 Schedule 20 para 6(4). If a source chargeable under Schedule D Cases IV or V which commenced prior to 6th April 1994 ceases prior to 6th April 1998, the old rules continue to apply under FA 1994 Schedule 20 para 7.

In 1997/98 the income will be assessed for the accounting year ending in the fiscal year as income from a deemed second trade as explained above, which will result in a transitional overlap where the strict fiscal year basis has previously applied.

This would be relieved for each partner on his share on leaving the partnership.

There can also be a cessation if the overseas trade or profession ceases and there is no other untaxed income to allow the deemed second trade to continue. There is, however, no cessation enabling the recovery of overlap relief merely because, for example, the interest in the overseas partnership is disposed of, if there is any other untaxed income of the deemed second trade continuing. Although there is only a single deemed second trade for the purpose of allocating such income by reference to the partnership basis period, rather than the fiscal year, each partner would return and self assess each separate element of the income constituting the deemed second trade and pay tax accordingly.

If the income for 1995/96 of the foreign partnership was assessed on the actual fiscal year basis as a result of the partners electing under TA 1988 s.66(1)(c), the averaging provisions do not apply for 1996/97 which would also be assessed on a fiscal year basis under FA 1994 Schedule 20 para 6(3).

Income from let property overseas

In most cases the letting of foreign property by a UK partnership gives rise to income assessable under Schedule D Case V, as the activities do not amount to a trade under Schedule D Case I. There were no statutory provisions under the old rules which stipulate the expenses that would be allowed in computing the taxable rental income but Revenue practice was to permit a deduction for current expenses incurred abroad, such as repairs, insurance, real estate taxes, management and letting fees. The Revenue maintained that in strictness only expenses incurred abroad were deductible so that, for example, advertising the overseas property in the UK would not be deductible. They based this argument on the Finance Bill Parliamentary debate in 1914 which provided for income from overseas properties to be assessed on the arising, rather than remittance, basis for the first time, and it appeared that the intention of the original legislation was to liken the arising and remittance bases and it would, therefore, be unfair to give greater relief for income arising than on income remitted. The Revenue view was not universally accepted and in some cases UK expenses were allowed by local districts after negotiation or by default. Interest used not to be a deduction from the rents of a foreign investment property following *Ockenden v Mackley* [1982] STC 513, but such interest became allowable from 6th April 1994 following the amendment to TA 1988 s.353(1) by FA 1994 s.81(1). Under the self assessment rules, Schedule A income is computed under Schedule D Case I lines and this is extended to income from overseas property by FA 1995 s.41 which introduced TA 1988 s.65(2A) and (2B). The computation of Schedule A income on Schedule D Case I lines should ensure that all interest and other legitimate expenses wholly and exclusively incurred for the purpose of the Schedule A business are deductible. For 1995/96 and 1996/97, FA 1995 s.41(6) requires that the income from each property outside the UK be separately computed, and each partner in a UK partnership would be assessed for those years on his share of the net income from each property arising in each fiscal year. For 1997/98 the income is brought into charge as income from the deemed second trade by reference to the accounting period ending in the current fiscal year and any overlap given to a partner leaving under FA 1994 Schedule 20 para 6.

As with trading and professional income, where a non-statutory basis has applied, normally on the basis of the profit shown by the accounts for the year ending in the preceding fiscal year, the Revenue will apply the normal Schedule A transitional averaging rules, but by reference to the partnership accounting date rather than by reference to the fiscal year, to avoid going from a non-statutory accounts year basis in 1994/95 to a strict fiscal year basis for 1995/96 and 1996/97 and back to an accounts basis for 1997/98. This is explained in the Inland Revenue's Tax Bulletin issue 21 (February 1996) page 283 et seq. The furnished lettings provisions do not apply to overseas holiday letting businesses in view of TA 1988 s.65A(3).

There used to be no statutory relief for losses in respect of income from overseas lettings although, under Extra-Statutory Concession B25, deficiencies of income from letting of overseas property, including caravans and house boats, could be carried forward for set-off against future income from the same property. This remains the position for losses for all years of assessment up to 1996/97, but any remaining deficit at the end of 1996/97 may be carried forward and set against the total net rental income from overseas property for 1997/98, as the Schedule A rules for losses apply under TA 1988 s.379A by virtue of TA 1988 s.65(2A) and (2B). However, TA 1988 s.65A(1) provides that income and losses from overseas properties are effectively ring fenced and any losses could not be set against Schedule A income from UK properties. TA 1988 s.65A(2) specifically disapplies TA 1988 ss.80 and 81 which would otherwise give relief for travelling expenses for visits to the overseas properties. Relief for such expenses are therefore only available if it can be shown that they are incurred wholly and exclusively for the purposes of earning the rental income.

Income from Foreign Securities and Investments

Income of a UK partnership from overseas securities assessable under Schedule D Case IV, or investments assessable under Schedule D Case V, will normally have been taxed by reference to the income accruing to each individual partner in the preceding fiscal year. For 1996/97 the income will be one half of the aggregate of the income arising in the fiscal years 1995/96 and 1996/97 under FA 1994 Schedule 20 para 6(1) and (2)(a), unless 1995/96 was assessable on a fiscal year basis, in which case so is 1996/97 under FA 1994 Schedule 20 para 6(3).

For 1997/98 for a pre-6th April 1994 partnership or from commencement for a post-5th April 1994 partnership, the assessment will be by reference to each partner's share of the income arising in the accounting period as income of the deemed second trade. To the extent that this gives rise to overlap compared with the previously applied fiscal year basis, FA 1994 Schedule 20 para 6(4) allows overlap relief under TA 1988 s.63A when a partner leaves, giving rise to a deemed cessation of his deemed notional second trade, or as normally on a change of accounting date for the partnership resulting in a basis period of more than 12 months.

Foreign Partnerships

A UK resident may be a partner in a partnership controlled abroad, as defined by TA 1988 s.112, as a direct partner as opposed to being entitled to the overseas income of a UK partnership as a result of its interest in a foreign branch, agency or partnership.

TA 1988 s.112 used to provide that where a trade or business is carried on by two or more persons in partnership and the control and management of the trade or business is situated abroad, the trade or business should be deemed to be carried on by persons resident outside the UK and the partnership should be deemed to reside outside the UK notwithstanding the fact that some of the members of the partnership are resident in the UK and that some of its trading operations are conducted within the UK. These provisions are unnecessary under self assessment for a UK resident and domiciled partner who is assessed on an arising basis on his world-wide income under Schedule D Case I or II instead of, as previously, Schedule D Case V. This, however, does not affect the tax payable because under TA 1988 s.65(3) Case I principles are now fully applied to Schedule D Case V income derived from a trade, profession or vocation either solely or in partnership. The Schedule D Case I or II treatment arises from TA 1988 s.111(2) which provides that the partnership is deemed to be an individual resident in the UK, for a UK resident and domiciled partner.

Schedule D Case V treatment is, however, preserved for partners resident but not domiciled in the UK or non-ordinarily resident Commonwealth citizens or citizens of the Republic of Ireland under TA 1988 s.112(1A), provided that the trade, profession or business is carried on in partnership wholly or partly outside the UK and the control and management is also situated outside the UK. This is achieved by treating his entitlement to share in any profits or gains arising from the partnership as if it were a possession outside the UK. The remittance basis would therefore continue to apply to such a partner.

If a resident partner becomes non-resident or a non-resident partner becomes resident there is a deemed cessation to the deemed sole trade under TA 1988 s.112(1B), although losses can be carried forward through the deemed cessation under TA 1988 s.385. These provisions parallel those of an individual carrying on a trade, profession or vocation wholly or partly overseas under TA 1988 s.110A. The effect of the provisions is merely to ensure that a resident partner is taxable on his world-wide income, unless the remittance basis applies, and a non-resident partner only on income arising in the UK, as explained below.

In *Padmore v IRC* [1989] STC 493 it was successfully argued that the share of profits for a UK resident partner in a foreign partnership protected by appropriate wording in a double taxation treaty was not subject to UK tax. This decision was overruled by F(No.2)A 1987 s.62 which became TA 1988 s.112(4) and (5) and which continue to apply for self assessment.

These changes come into effect from 1997/98 for pre-6th April 1994 partnerships and from 1995/96 for partnerships set up and commenced after that date: FA 1995 s.125(1).

Remittance Basis

Where a UK resident partner in receipt of partnership income from abroad is himself not domiciled in the UK, or is a Commonwealth citizen or citizen of the Republic of Ireland and not ordinarily resident in the UK, the income is assessed on the remittance basis under TA 1988 s.65(4) to (9). Where the remittance basis applies the partner is not taxed by reference to his share of the overseas income as shown by the partnership accounts but purely by reference to the amount of overseas income remitted to the UK. It is important to ensure that where possible any remittances to the UK are therefore out of capital and foreign income should be identified in a separate bank account.

Chargeable gains are assessed on the remittance basis under TCGA 1992 s.12(1), and therefore the proceeds arising on the sale at a profit of overseas investments should not be remitted to the UK, if possible, as the pro rata gain element will be taxable. The proceeds of investments sold at a loss can be added to the remittable capital as these would not be remittances of income or capital gains; *Timbrell v Lord Aldenham's executor* (1947) 28 TC 293.

Remittances of a mixed fund of income and capital are treated in the first instance as remittances of income; *Scottish Provident Institution v Allan* (1901) 4 TC 409 and 591. A remittance that exceeds the income contained in a mixed fund is treated as a mixture of capital and capital gains remitted pro rata; (see Inland Revenue Manual CG 25401). Remittances within the same tax year, but after the source has ceased, are caught; *Joffe v Thain* (1955) 36 TC 199. Remittances of income in a fiscal year following the cessation of the source are not taxable (*Kneen v Martin* (1934) 19 TC 33) unless the remittances are remuneration assessable under Schedule E Case III which are caught by TA 1988 s.19(1) 4A. It seems that if the Schedule D Case V source ceases and the remittance basis applies, a remittance of income in the following fiscal year will escape taxation on the basis that the source has ceased even though there may still be income deemed to arise from the deemed second trade of the partnership under TA 1988 s.111(8) in respect of other non-trading income.

Non-Resident Partners

A non-UK resident partner carrying on a trade, profession or business in partnership is assessed as if the partnership were an individual not resident in the UK, and his share of profits is limited to the share of profits or gains or losses derived from the trade or profession carried on by him in the UK; TA 1988 s.112(1).

These provisions were explained by the Inland Revenue Tax Bulletin issue 18, August 1995, page 237 et seq: "Non-residents are taxed in the UK on the shoreline principle, that is on income arising in or connected with the UK."

"The new rules leave the provisions for charging tax on the income of non-residents, from carrying on a trade, profession or vocation, unchanged. The main rule is in paragraph (a) (iii) of Schedule D in TA 1988 s.18(1), which limits the charge to trades, professions and vocations exercised within the UK.

Two main principles were established in early tax cases. First, trades carried on wholly or partly in the UK, including trades carried on by non-residents, are chargeable under Case I of Schedule D. Trades carried on wholly outside the UK are chargeable under Case V of Schedule D which is limited by paragraph (a) to UK residents; *Colquhoun v Brooks* (1889) 2 TC 490, *San Paulo (Brazilian) Railway Co v Carter* (1895) 3 TC 407. Second, trades carried on by non-residents are chargeable only where the non-resident trades in the UK, which means broadly that economic activities are carried on in the UK that give rise to trading profits, e.g., sales or manufacture. Trading by non-residents with the UK as opposed to in the UK (e.g., purchases or delivery) is not chargeable; *Erichsen v Last* (1881) 1 TC 351 and 4 TC 422, *Pommery and Greno v Apthorpe* (1886) 2 TC 182, *Werle v Colquhoun* (1888) 2 TC 402, *Grainger and Son v Gough* (1896) 3 TC 311 and 462, *Smidth & Co v Greenwood* (1922) 8 TC 153, *Firestone Tyre and Rubber Co Limited v Llewellin* (1957) 37 TC 111.

These principles are well understood. They are also in line with the principles in the OECD Model Tax Convention which exempt trading functions of a resident of the other state from charge if they are solely of a preparatory or auxiliary nature.

It is also well understood that where a non-resident carries on a trade partly in the UK and partly outside the UK the charge is limited to the profits from the part of the trade carried on in the UK.

It is perhaps less obvious how the profits from the part of the trade carried on in the UK should be measured. They are required to be measured on the arm's-length principle set out in the Model Tax Convention where a double taxation agreement applies which includes the relevant provisions. It is considered that it also follows from the main rule in Schedule D that the same principle applies even if there is no treaty.

There is support for this principle in the early tax cases on non-residents trading in the UK; for example, in *Pommery and Greno v Apthorpe* (1886) 2 TC 189, Denman J said with regard to the profits chargeable in the UK from merchanting champagne produced in France, that

'It may be that there may be some difficulty in some respects as to the manner of calculating the amount of expenditure against the profits. Whether it would be a proper course to look at the goods sent over to England and then to consider what profit they make, putting a fair valuation on them as they arrive and as the money is transmitted, or whether it would be necessary in such cases to look more minutely into the profits and losses upon the whole trade carried on partly in France and partly in England. I do not think it is necessary at all at this stage of the case to decide that. That is a matter of quantum, a matter for the consideration of persons skilled in dealing with such matters as assessing profits or trade.'

This can be seen as an early description of the arm's-length principle and as a recognition of the need to develop methods to apply that principle in practice. Such methods were developed in the OECD 1979 report on Transfer Pricing and Multinational Enterprises and have been reaffirmed and clarified in the recently published 1995 revision of that report by OECD, 'Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations'"

"To summarise, it is generally agreed by taxpayers, tax advisers and the Inland Revenue that the arm's- length principle, as set out in the Model Tax Convention and explained in OECD publications, applies to the measure of profits chargeable on a non-resident in respect of trading in the UK as a matter of law, irrespective of whether a double taxation agreement applies."

The effect of these rules for an overseas partnership trading in the UK can be highly advantageous. If, for example, a foreign professional practice opens a branch in the UK supervised by two partners sent over to the UK to run it, each partner would, under the partnership agreement, be entitled to his share of world-wide profits. The non-UK resident partners would only be liable to UK tax on their share of the UK branch profits as non-UK residents. If there were, say, 50 or more partners overseas, the share of UK profits taxable on each of them would be small and could well be covered by personal allowances to which they might be entitled under a double taxation treaty. The UK resident partners would also be liable to tax on their share of the UK profits. They would also be liable to tax on any remittances of non-UK income. If such remittances were kept to a minimum by living on capital or accumulated income remitted to the UK prior to arrival, the UK resident partners' tax liability would also be modest.

Example:

Mr Grummon came to the UK on 1st January 1998 to start the UK branch of a US Law firm which made up accounts for the calendar year. On 1st July 1999 he was joined by Mr Northrop. Both remained partners of the US firm. The UK branch made profits of £50,000 in 1998, £200,000 in 1999 and £250,000 in 2000 and the US firm made profits of $15,000,000 world-wide, shared equally by the 50 partners.

Mr Grummon remitted overseas profits to the UK of £100,000 in December 1997, £20,000 in December 1998 and £30,000 in December 1999.

Mr Grummon's assessable income was:

	£
1997/98	
Deemed UK resident from 1.1.98 - ESC A11	
Share of UK profits $\frac{£50,000}{50}$ x 3/12	250
Remittances of world-wide profits since 1.1.98	NIL
Personal allowances - say	(3,765)
Self assessment	NIL
1998/99	
Share of UK profits $\frac{£50,000}{50}$	1,000
Remittances of world-wide income	20,000
	21,000
Personal Allowances - say	(3,765)
Self assessment	17,235
1999/2000	
Share of UK profits $\frac{£200,000}{50}$	4,000
Remittances of world-wide income	30,000
	34,000
Personal allowances - say	(3,765)
Self assessment	30,235
2000/01	£
Share of UK profits $\frac{£250,000}{50}$	5,000

Remittances	NIL
Personal allowances - say	(4,000)
Self-assessment	1,000

Mr Northrop's assessable income was:

1999/2000		
	Deemed UK resident from 1.7.99 - ESC A11	
	Share of UK profits $\frac{£200,000}{50}$ x 6/12	2,000
	Plus 1.1.99 to 5.4.2000 $\frac{£250,000}{50}$ x 3/12	1,250
	Remittances since 1.7.99	60,000
		63,250
	Personal allowances - say	(3,765)
	Self-assessment	59,485
2000/01		
	Share of UK profits $\frac{£250,000}{50}$	5,000
	Remittances	NIL
	Personal allowances - say	(4,000)
	Self-assessment	£1,000

The US partners' share of UK profits were covered by personal allowances under the Anglo/US double taxation agreement SI 1980 No 568 Article 24(1), non-discrimination.

UK Investment Income of Non-resident Partners

As the partnership is deemed to be a non-resident individual for non-residents under TA 1988 s.111(2) and 112(1), the deemed second trade rules apply to fix the basis period as the accounting period of the partnership as opposed to the fiscal year. The income is otherwise assessed as if each partner's share of that income were held by him as a non-resident individual, subject to the comments set out below.

Income from Land in the UK

Tax is assessed under Schedule A on income from land in the UK. Under the self-assessment rules which came into operation on 6th April 1996 a non-resident may elect to self-assess in respect of Schedule A income rather than to suffer deduction of tax at source. TMA 1970 s.42A was inserted by FA 1995 s.40 to set out the statutory framework. The flesh on the bones is provided by the Taxation of

Income from Land (Non-Residents) Regulations 1995, SI 1995 No 2902. Although the Schedule A provisions for non-residents are usually dealt with by the Financial Intermediaries and Claims Office (FICO), in the case of ancillary income of a partnership trading in the UK the partnership return and statement would be submitted to the normal district for where the partnership is based.

UK Representative

The partnership as a deemed entity is appointed a non-resident partner's UK representative under FA 1995 s.126(5),(6) for the assessment and collection of tax. Where there is a UK resident partner, the partnership is treated as the branch or agent of each non-resident partner in respect of his share of partnership profits; FA 1995 s.126(7). This applies to the partnership's other income as well as to its trading profits under TA 1988 s.111(8) and has the effect of making any partners present or resident in the UK jointly liable for tax on the non-resident's share of partnership profits, which overcomes the difficulty of collecting tax from a non-resident partner under the general rule that a country cannot proceed against the resident of another country for the collection of tax; *Government of India v Taylor* (1955) 34 ATC 10. It also has the effect of retaining the previous joint and several liability of partners for the tax liabilities of non-resident partners even though such liability will no longer apply under self-assessment for a UK resident partner in respect of the tax liability of other UK partners, as TA 1988 s.111 makes each partner liable for his own tax as if he were carrying on a notional sole trade.

In the unusual case where the non-resident partnership trading in the UK was trading through a branch without any UK resident partners, the branch itself would be appointed the non-resident partners' UK representatives.

Higher Rate Liability

Under FA 1995 s.126(1) and Schedule 23 a non-resident partner is liable to both lower, basic and higher rate taxes in connection with trading or professional income or Schedule A income from property which arises in the UK. However, with regard to other investment income the legislation has been substantially amended and there is no further tax over and above the tax deducted at source on excluded income, as defined, which is received by an individual who does not have a UK representative for the purposes of FA 1995 s.126 and Schedule 23. This exclusion is contained in FA 1995 s.128(2B) but as the partnership is appointed just such a UK representative by FA 1995 s.126(5) it follows that this includes the investment income of the second deemed trade of the partnership under TA 1988 s.111(8) by reason of FA 1995 s.126(6). Such investment income is therefore liable to full UK rates of tax for a non-resident as income arising in the UK, subject to any exemption under a double taxation agreement.

It therefore follows that non-resident partners investing in the UK should do so directly as individuals, not through the partnership. This would then enable them to self-assess rental income under Schedule A under the normal Schedule A provisions of TA 1988 s.42A and to qualify for the excluded income rules in FA 1995 s.128(3) limiting the UK tax charge to the tax deducted at source, if any. Such income includes income from Government securities, deposit interest and other income taxable under Schedule D Case III, dividends taxable under Schedule F, income from certificates of deposit with financial institutions and banks, taxable under Schedule D Case VI under TA 1988 s.56, social security benefits, notably retirement pensions and unemployment benefit taxable under Schedule E under TA 1988 s.150 or 617, and incapacity benefits taxable under FA 1994 s.139. Also included is income received through a broker or investment manager that meets the requisite conditions for exemption in FA 1995 s.127 such as commodity dealing or trading in derivatives, other than underwriting profits as a Lloyd's name. The Treasury is given power to designate any other income by statutory instrument under FA 1995 s.128(3)(e) but has yet to do so.

Chargeable Gains

A non-resident is not normally liable for UK capital gains tax as TCGA 1992 s.2(1) confines the charge to persons resident or ordinarily resident in the UK. However, TCGA 1992 s.10 brings into charge gains on assets used for the purposes of a trade, profession or vocation carried on in the UK where the assets are situated in the UK, which means that, broadly speaking, assets used in a UK partnership would be subject to capital gains tax on a non-resident and the appointment of the partnership as UK representative applies also for capital gains tax under FA 1995 s.126(1). Payment of the tax would therefore be the responsibility of the UK partners.

A UK resident but non-domiciled partner is liable to capital gains tax only in respect of gains on disposals of assets in the UK or on remittances of overseas gains, under TCGA 1992 s.12.

Conclusion

The changes made as a result of the introduction of self-assessment to the taxation of partnership income where there is a foreign element may not be revolutionary but the detailed rules are sufficiently complex to require careful study.