

# Squaring up

**JULIE BUTLER** considers the penalties of partnership conflict.

Most farming operations trade through the legal entity of a partnership. It has also been said that a starting point for the understanding of acting for farmers is that, almost inevitably, disagreements among partners will arise. It is, therefore, quite possible, and indeed frequent, that individual partners will dispute aspects of the treatment of the partnership business accounts and tax issues. Several recent tribunal cases have provided guidance on the depth of the farming partnership conflict and the correct tax treatment.

A recent case flags up the need for all advisers to be careful about partnership property assumptions and the need for clear legal definition. The case of *Ham v Bell* [2016] EWHC 1791 (Ch) came before the High Court to decide whether the farm, which had been an asset of the old partnership of Mr and Mrs Ham senior, became an asset of the new partnership with their son.

The key point of whether the farm was partnership property was the intention of its original owners, Mr and Mrs Ham. It was decided that accounts were no more than evidence and, if they did not reflect what was agreed, they could be disregarded. The **Case Summary** shows the need for accountants to ensure that the accounts reflect intentions and they should, if necessary, ask the clients to take legal advice on this.

## The concept of independence

If there are such disagreements, the tax advisers must consider conflicts of interest. This is especially so when, for example, an accountancy firm acts for the partnership and the partners. In such a case, can the partnership adviser act with independence for all the individuals, particularly if there is a dominant lead partner for whom they act? In a case such as *Ham v Bell*, at what point does the accountant decide whom they can and cannot act for? The assumption is that this should be at a very early stage in the dispute.

### KEY POINTS

- Disputes will often arise within partnerships.
- In *Ham v Bell*, the point at issue was whether a farm was a partnership asset.
- Advisers must always watch for conflicts of interest.
- Can partners declare different profit share figures on individual tax returns from those shown on the partnership form?
- Penalty problems when partners leave or divorce.



## Different profit share figures

In *R King and others* (TC5163) the issue before the First-tier Tribunal was whether partners were entitled to declare different profit share figures on their individual tax returns from those shown on the partnership return if they believe that the latter is incorrect. The question was previously considered in *Morgan and Self v HMRC* (TC46). HMRC's published guidance (at EM7025) was examined. The guidance it gives is as follows:

- 'Where there is a genuine disagreement that cannot be resolved between the partners, individual partners should:
- enter, as their share of partnership profits, the amount they consider to be correct; and
  - advise us that they have done so by making an entry in the white space notes section of the return to show:
    - the profits as allocated in the partnership statement;
    - a deduction (or addition) of the disputed amount; and
    - an explanation about why they think the profit allocated to them in the partnership is wrong.'

In *Morgan and Self*, there had been no enquiry into the partnership return: both the partnership and HMRC believed it to be correct. The question was whether the individual partner was bound to make their return on the same basis. The answer was no.

A comparison with farming could be when the lead partner and an individual partner disagree over the private use of a business asset. The key is that the individual partner is signing the declaration that, to the best of their knowledge, the personal tax return is correct and complete. But in the farming example we consider that an individual knows the accounts do not include enough private usage.

The tribunal adopted the judge's reasoning in the *King* case that the statutory provisions (TMA 1970, s 8) 'do not appear to deal with the case where a partnership and individual partner disagree'. It was therefore necessary to establish the correct amount of tax. ITTOIA 2005, s 25 provides that profits of a trade must comply with the Companies Act 2006 and be compliant with generally accepted accounting practice (GAAP).

## CASE SUMMARY

*Ham v Bell and others* [2016] EWHC 1791 (Ch)

The proceedings concerned a dairy farm in Somerset of around 900 acres, which were partly owned and partly rented by the second and third defendants, RH and JH (together, the parents). The parents carried on business in a partnership (the old partnership). The first defendant was the parties' land agent. In 1997, the claimant, who was the son of the parents, was made a partner in the family business. A written partnership agreement was created for the new partnership. A dispute arose as to the extent of the partnership.

The central issue was whether the farmhouse, the buildings and the land (together, the farm), as of September 1997 when they had been assets of the old partnership, had become assets of the new one on 1 October 1997, because of their appearance in its accounts between 1998 and 2003.

The defendants submitted that the inclusion of the farm in the accounts for that period had been an error, which had been rectified in the accounts from 2004 to 2008. They submitted that they had never intended to make the farm an asset of the new partnership.

The claimant contended that an implied agreement was to be inferred from the conduct of the parties. Among other things, the claimant relied on the accounts of the new partnership between 28 February 1998 and 28 February 2003, none of which had been signed in manuscript by the parties. Consideration was given to the conduct of the accountants who had drawn up the accounts.

The claim would be dismissed.

There was no evidence that any discussion had taken place between the accountants and the claimant or between the accountants and the defendants about whether the farm had become a partnership asset. On the evidence, the accountants had continued to prepare the accounts after the new partnership started in the same way that he had always prepared them beforehand, but without giving any proper thought to whether the farm was or was not to be an asset of the new partnership. It was likely that the accountants had not thought that there had been an agreement to make the farm a partnership asset.

By mistake, they had continued to show the farm as an asset of the new partnership. That had been an error because, on the evidence, there had been no agreement between the parties that this would be the case. That mistake had been corrected in the 2004 accounts and the correction had been duplicated in the accounts for the following years.

The accounts themselves did not provide for the agreement for which the claimant contended. Before the dispute between the parties had arisen, the defendants had doubtless thought that they and the claimant would all carry on together farming on the land until the defendants' death, when the claimant would continue the business. However, that was a long way from an agreement or understanding that the farm had become an asset of the new partnership.

## The detail of the *King* case

The taxpayers were members of a limited liability partnership (LLP) accountancy firm, BTG. In November 2011, it was acquired by Smith & Williamson LLP, as a result of which the partners had ceased to be members of BTG and became members of that practice or another firm of accountants. The BTG accounts had been audited by Deloitte which confirmed they were compliant under generally accepted accounting practice (GAAP). They showed a loss but, because of an 'add back' by designated members, the partnership return included a profit.

The tribunal judge did not agree with the original HMRC view – the amendments were made pursuant to the closure of enquiries into the personal returns, there was a right to appeal against them and furthermore the appeals would be upheld.

## Reasonable excuse for lateness

Another recent case involving two farming and building partnerships, *Porter v CRC* (TC5156), concerned an appeal on penalties arising from the late submission of personal and partnership returns (see [tinyurl.com/hlx2dgm](http://tinyurl.com/hlx2dgm)). Mrs Porter was involved in an acrimonious divorce with her husband with whom she was in partnership. The appeal was over the late submission of the partnership return.

It was considered that Mrs Porter had a reasonable excuse for her late submission. She was not the nominated partner and had been excluded from the management and direction of the partnerships at the material time. It was considered reasonable to assume that the partnership accountant had been instructed by her husband who would have submitted the return.

The tribunal accepted that Mrs Porter did not become aware of the failure to lodge the return until after the submission deadline.

## Action plan for partners

In the *Ham*, *King* and *Porter* cases it can be argued that the individuals should have a separate adviser who would have been able to check and advise on all such matters. Advisers acting for the partnership should ensure (where there is any doubt) that all partners receive details of draft accounts and queries and are kept updated on filing deadlines. Likewise, they must understand the legal ownership of partnership property.

If there is any dispute within a partnership, the appointment of separate advisers for each of the partners should be considered at an early stage. If an adviser acts for, say, the partnership and principal partner, who may not be allowing the others full access to information, they should consider their position on the important position of independence.

All these cases show the complexity and the importance (some would argue stress) of the compliance issues surrounding partnership accounts and tax returns and to ensure they reflect what the partners agree. ■

**Julie Butler FCA** is the author of *Tax Planning for Farm and Land Diversification* (Bloomsbury Professional), *Equine Tax Planning* ISBN: 0406966540, and *Stanley: Taxation of Farmers and Landowners* (LexisNexis). Julie can be contacted by phone on 01962 735544 or email [j.butler@butler-co.co.uk](mailto:j.butler@butler-co.co.uk).