

The penalties of partnership conflict

What happens when accounting disagreements arise within a partnership? Julie Butler highlights recent tribunals which give guidance.

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 "all farming families hate each other". Therefore it is quite possible, and indeed frequent, that individual partners disagree on treatment of accounts and tax issues within the partnership. There have been a number of recent tribunal cases that have helped give guidance towards the depth of the farming partnership conflict and the correct tax treatment.

Definition of partnership property

A recent case regarding the defining of partnership property flags up the need for all advisers to be careful with regard to partnership property assumptions and the need for clear legal definition. The case is *Ham v Bell* [2016] EWHC 1791 (Ch) which came before the High Court with regard to 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 deciding whether it was partnership property was what the original owners of the farm, Mr and Mrs Ham, intended. It was decided that accounts are no more than evidence and if they do not reflect what was agreed, they could be disregarded. This shows the need for accountants to ensure that the accounts reflect what was agreed and if necessary to ask the clients to take legal advice in respect thereof.

The important concept of independence

Where there are such disagreements the tax advisers must consider conflicts of interest. This is especially so in the example of where an accountancy firm acts for, say, the partnership and one or two partners, but not all the partners. In this example can the partnership adviser act with independence with regard to all the individuals, particularly where there is a dominant lead partner for whom they act? Let us now look at some of the tribunal cases. In the *Ham v Bell* case, at what part does the accountant decide who they can and cannot act for? The assumption is at a very early stage in the dispute.

Different profit share figures

In *R King and others* (TC5163) the issue before the first-tier tribunal was whether partners are entitled to declare different profit share figures on their individual tax returns from those declared on the partnership return if they believe that the latter is incorrect.

The question was previously considered in *Morgan and Self v HMRC* (2009) TC00046. HMRC's published guidance (in its Enquiry Manual 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 the return to be correct. The question was simply whether the individual partner was bound to make his or her return on the same basis and the answer was no.

Comparison to farming

A comparison with farming is, say, private usage where, for example, the lead partner considers that the amount should be less and an individual farming partner argues a more robust figure. The key is that the individual partner is signing the declaration on his return that to the best of his knowledge is correct and complete. But in the farming example we consider where 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 GAAP compliant.

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 Smith & Williamson 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 late submission

Another recent case involving a farming and building partnership, *Porter v The Commissioner for Revenue and Customs* [2016] UK FTT 401, concerned an appeal in relation to penalties arising from the late submission of personal and partnership returns. Mrs Porter was involved in an acrimonious divorce with her husband. The appeal was over the late submission of the partnership return (she was in partnership with her husband).

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 both 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

It can be argued that in *Ham*, *King* and *Porter* the individuals must 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, queries and are kept updated as to filing deadlines. Likewise, they must understand the legal ownership of partnership property.

Where there is any dispute within a partnership, separate advisers for each of the partners should be considered at an early stage.

Where the adviser acts for, say, the partnership and the lead adviser, who is perhaps not allowing full access to the information by all the partners, they should of course consider their position with regard to the very 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 to ensure they reflect what the partners agree.

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