Using Partnerships in International Tax planning

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Contents

Partnerships

- More permanent structures for long-term trading or business relationships between the partners.

- Three types:
- - General (GP)
- - Limited (LP)
- - Limited Liability (LLP)

- Specific tax rules

- Strong legal relationship – partners are agents

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Limited Partnerships

- Governed by LPA 1907
- Tax transparent; no treaty relief in their own right.
- LPs in England & Wales have no separate legal personality.
- Scottish LPs are separate legal entities.
- Mostly used for investment funds.
- LPs have general unlimited liability partners and limited liability partners.

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LPs

- Similar legislation allows LPs in:
- - Delaware
- - Cayman Islands
- - Bermuda
- - Guernsey
- - Jersey.

- HMRC consider Cayman and Guernsey LPs as transparent, but not Delaware LLCs.

- FSMA 2000 operator must be authorised by FSA

- LPs lend investment capital as capital controls allow it to be clawed back.

Limited Liability Partnerships

- LLP Act 2000 created hybrid tax transparent entity.
- Created ‘with a view to a profit’
- LLP’s partners collectively liable to extent of original investment.
- Failure to carry on business = loss of tax transparency.
- Not used for funds
- Management of investments = trade (confirmed by HMRC).

LLPs

- Two ‘designated’ partners with added compliance roles.
- Additional compliance duties (annual returns)
- S.59TCGA ignores corporate status for CGT and taxes partners.
- FA 2011 exemption of foreign branch profits from corporation tax for UK resident company members of LLPs
- LLPs cannot be treated as ‘group companies’ for CT purposes.

Partnerships – Crown dependencies

- Jersey incorporated LP (body corporate)
- Jersey separate LPs (legal personality; not corporates)
- Jersey LLP (partnership with separate legal personality; not corporate)
- Guernsey – incorporated/unincorporated
- Isle of Man – LPs or general partnerships.
- Distinctions crucial for tax, asset protection or succession.

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Limited Liability Companies

- Hybrid of company and partnership benefits.
- Statutory insulation for investors against liability
- Elimination of double taxation (tax transparency in US).
- HMRC sees them as taxable entities.
- US corporate image (for Delaware and others US States)
- No public accounts

LLCs

- Low annual registration costs (any US state, common in Delaware)

- To be transparent in US must meet two out of four:
- limited liability
- central management
- continuity of life
- stock freely transferable.

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The OECD position

- Partnership defined by legal not tax position
- Includes transparent and non-transparent entities.
- No problem if both contracting states treat partnerships the same way.
- Recognises that different states treat same entities differently (see *Swift*)
- OECD Report 1999 and revision to commentary to model convention.
- OECD recognises there are problems

Model Convention points

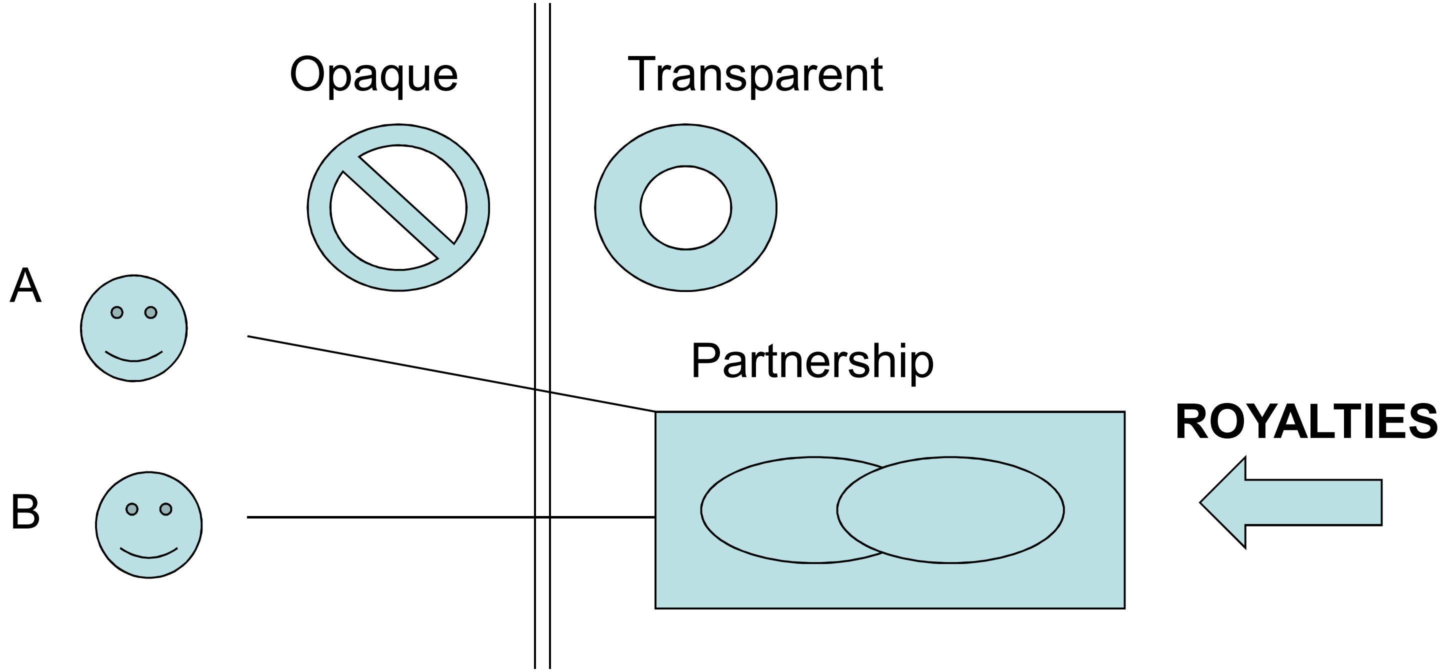
- LLP has to be '*a person who is resident*' (Art. 1) in a contracting state.
- LLPs and partners will either be 'companies' or 'bodies of persons' (Art. 3)
- As a person, it has to be 'resident' (Art. 4)
- To be resident, it must be 'liable to tax' by reference to Art. 4(1) criteria (e.g. domicile, residence etc).
- Usually irrelevant as residence determined by what it does and where.

Entitlement to treaty benefits

- Not resident where it is tax transparent.
- Opaque partnerships will be resident.
- Partners resident where partnerships are transparent.
- Receive income from state where they are not transparent.
- Partners should get treaty benefit
- OECD encourages states to make special provisions (see Germany/Italy DTA).

The other way round?

- Partners resident where partnerships are opaque.
- Receive income from state where they are transparent.



- A and B not liable to tax on P income; not entitled to benefit under convention; not beneficial owners of income.

Problems

- Arise when contracting state does not regard partnership as resident.
- (Art. 7) Recognition of loans and interest paid to/from partners and partnerships.
- Problems where one or both contracting states take different approaches.
- Conflicts in income allocation.

Tax planning issues

- Establish how each contracting state treats partnerships.
- Key to operation of treaty articles, not just Arts. 3 & 4.
- Drafting of operating agreement is crucial.
- Often needs to be more than just 'off the shelf' agreement
- Apply your mind to partnership constitution.

Issues continued

- Check treatment of loans by partners to partnerships.
- If loans not recognised, consider altering funding.
- Check treatment on allocation of profits.

Transparency – *Swift decision*

- Separate legal existence to its members?
- Issue share capital, or equivalent?
- Members entitled to profits as they arise?
- Who has/does the following: business or members?
- conducts the business activity;
- Responsible for debts;
- Beneficial ownership of business assets

Opportunities

- Partnerships can be body corporates and get benefit of participation exemption.

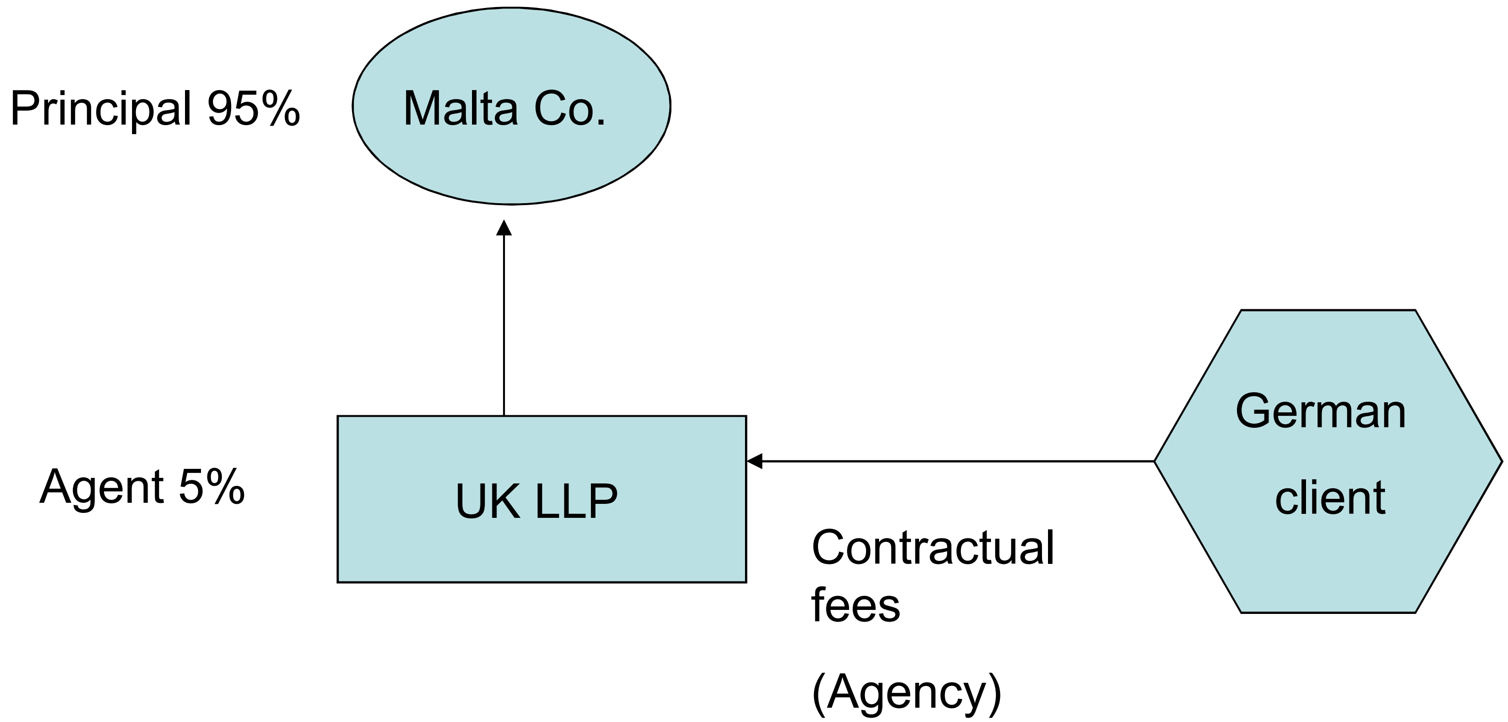
- Relief on transfer of assets between entities (i.e. to/from LLP to company)

- No gain/no loss.

- Check domestic legislation to see if treated as group company.

Uses – Participation Exemption

- Relief from corporate income tax from qualifying shareholding in another.
- LLP is a body corporate in Malta



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