Law Society of Scotland

Consultation Response

Limited partnerships: reform of limited partnership law

July 2018

Introduction

The Law Society of Scotland is the professional body for over 11,000 Scottish solicitors. With our overarching objective of leading legal excellence, we strive to excel and to be a world-class professional body, understanding and serving the needs of our members and the public. We set and uphold standards to ensure the provision of excellent legal services and ensure the public can have confidence in Scotland's solicitor profession.

We have a statutory duty to work in the public interest, a duty which we are strongly committed to achieving through our work to promote a strong, varied and effective solicitor profession working in the interests of the public and protecting and promoting the rule of law. We seek to influence the creation of a fairer and more just society through our active engagement with the Scottish and United Kingdom Governments, Parliaments, wider stakeholders and our membership.

The Society's Banking, Company and Insolvency Law Sub-committee and Limited Partnership Working Group welcome the opportunity to consider and respond to the Department for Business, Energy and Industrial Strategy's consultation *Limited partnerships: reform of limited partnership law*.[1] The Society has the following comments to put forward for consideration.

General remarks

A Scottish Limited Partnership (SLP) is a partnership formed in accordance with the Limited Partnerships Act 1907. The partnership consists of at least one general partner responsible for partnership management and a number of limited partners whose liability is limited to the capital they have contributed. The SLP has a legal personality of its own, distinct from that of its partners.

Many legal firms in Scotland offer SLP creation/management. They are a popular vehicle for use in investment, primarily for operating funds or holding commercial property.

Historically they were also common in the agriculture sector as a means of operating agricultural tenancies. Changes to legislation mean that they are no longer created for these purposes but many limited partnerships continue to operate so any new legislation must take account of the role of existing agricultural SLPs in the rural economy.

We are keen to support the government in ensuring that limited partnerships are not open to abuse by those engaged in criminal activity. We have therefore analysed the proposed measures with that objective in mind.

[1] https://www.gov.uk/government/consultations/limited-partnerships-reform-of-limited-partnership-law

At the same time any changes must avoid imposing disproportionate duties on legitimate businesses or creating administrative burdens, which will serve no useful purpose. The flexibility currently offered by the SLP, combining tax transparency with separate legal personality (and therefore the ability to hold property in its own name) makes it an attractive vehicle in the global marketplace.

SLPs are used within fund structures to pool assets of individuals and business entities and facilitate investments. Money is collected from partners who may be in the UK or elsewhere and invest in projects worldwide. They therefore support the position of the UK within the global economy and can facilitate foreign direct investment (FDI) flows as well as wealth creation elsewhere, which can bring benefits to the UK economy through tax revenues.

Furthermore, proper enforcement of existing rules is key to ensuring that legislation is complied with. BEIS has already noted the effects of the PSC legislation in reducing registrations of SLPs, which we understand BEIS views as a success. As a general rule, we advocate the importance of ensuring that time is allowed for legal measures to take effect before making further changes and it may be that in terms of the Scottish form, significant progress towards transparency has therefore already been achieved.

Response to questions

Question 1: Can you provide any additional evidence to help explain the trends in registrations of limited partnerships across the UK in recent years?

We are not aware of any evidence which could provide a definitive answer to this question.

Anecdotally members have reported an increase in work relating to SLPs for a range of commercial purposes, including funds. One of the particular advantages of the SLP is that it has separate legal personality, allowing partnerships to hold property while also offering the benefit of tax transparency. It would seem logical that increasing use of the form has led to greater awareness, promoting further use in turn.

Question 2: Do you agree that presenters should be required to demonstrate they are registered with an AML supervisory body? Please explain your answer, and provide evidence on its potential impacts.

We support the proposal that presenters should be required to demonstrate they are registered with an AML supervisory body. This would not cause any problems for law firms as they are already supervised by the relevant regulatory bodies in each UK jurisdiction and the majority of legitimate businesses will seek legal advice in any case.

We have identified a number of benefits which would result from this approach:

- It would clearly show which supervisor is responsible for each “presenter”, and therefore aid co-operation and delineation of responsibilities across supervisors;

- It could provide empirical evidence as to who is setting up SLPs (eg formation agents, accountants, legal firms);
- It would help in the development of supervisory management information;
- It would also help supervisors trace and follow up with firms if potential issues are identified.

At the same time, we recognise that there is a cost to those wishing to set up a limited partnership of seeking professional assistance; legitimate limited partnerships may therefore wish to file their registration directly with Companies House. If such a registration application is made, Companies House must ensure that it undertakes the same AML checks as would be required by professionals operating under the anti-money-laundering regulations.

Another option would be to introduce a requirement to produce an anti-money laundering certificate along with such "direct" registrations. This would need to be a thorough process to assess sources of wealth etc, not merely verification of identify. The certification process could be carried out by regulated entities (such as banks, law firms and accountants) which could charge a reasonable fee for the service.

We also note that this proposal would not address potential problems with existing businesses which were registered without appropriate AML checks having been carried out. The certification process outlined above could be used in conjunction with the confirmation process to remedy this situation. Existing limited partnerships should be given a reasonable length of time to carry out the certification process. As it would have retrospective application, we consider that it would be more appropriate to impose civil penalties for non-compliance.

Similarly, an initially "legitimate" limited partnership (as with any other partnership or company) may become a vehicle for improper purposes at a later date. We therefore reiterate the importance of effective enforcement of rules and ensuring that law enforcement agencies are properly resourced to carry out their tasks.

Question 3: How should this measure be applied to registrations from overseas?

Where an overseas applicant uses the services of an AML supervised presenter in the UK, they will have been subject to the same AML checks as UK applicants and should therefore be treated in the same way.

Registrations from overseas using foreign presenters should only be allowed from jurisdictions where there is recognised equivalence of AML controls, and similar supervisory functions.[2]

Where a direct registration (one with no presenter input) is made from overseas, this should only be possible if the applicants are subjected to proper AML checks.

[2] All EU Member States are subject to the same overarching rules as set out in the Fourth Anti-money Laundering Directive. Companies House would need to assess whether agents from other jurisdictions outwith the EU were eligible on a country by country basis.

As per the suggestions above, Companies House could be required to take on an active role in carrying out these checks or a certification process could be introduced to ensure the partners had been through the appropriate money laundering processes.

Question 4: Would it be better to require a limited partnership's principal place of business (PPoB) to remain in the UK, or alternatively to allow the PPoB to be based anywhere but require a UK based service address? Please evidence your answer, including if possible, an assessment of the likely costs of compliance.

It would be better to allow the PPoB to be based anywhere and require a UK based service address than to require a limited partnership's PPoB to remain in the UK.

While option A would be simpler from a supervisory perspective, this option seems unnecessarily restrictive. Pursuing this approach would be likely to seriously diminish the attractiveness of UK business vehicles for the funds industry. Funds are often managed outside the UK and the place of main operations is subject to change, for example where an investment is taken out of one jurisdiction and invested in another, it may be helpful to have management located closer to the asset or assets in question. If it was mandated that the principal place of business had to be in the UK, this flexibility would be lost. Funds not wishing to base operations in the UK on a permanent basis would be likely to seek to establish elsewhere, through a vehicle which allowed them to operate in a more flexible way.

Another advantage of the SLP in particular, lies in the fact that it has separate legal personality while also offering tax transparency. Tax transparency allows tax authorities to "see through" the partnership structure meaning partners are subject to direct taxation but the partnerships itself is not taxed. SLPs may therefore fulfil domestic regulatory requirements, which individual partners are bound by, again providing a key attraction for international investment purposes.

Option B (the service address option) is therefore preferable: it would ensure a connection to the UK on an ongoing basis and would provide a concrete address, for example for service of official documents, but not restrict SLPs in terms of where they base their business.

Furthermore, we are of the view that limited partnerships should be on a par with other business entities in terms of flexibility to establish in the UK but operate globally, as long as they comply with relevant legal requirements. The SLP will often be selected for tax transparency: tax efficient business operations may be centred elsewhere or spread across a number of locations. This flexibility makes the SLP an attractive vehicle for funds which operate internationally. Being able to offer robust user-friendly vehicles is important to the UK's position within the global marketplace. This policy of ensuring Scotland is open to international

business would be consistent with the policy to ensure the Scottish commercial sphere is up to date as demonstrated through, e.g. the Scottish Arbitration Act and ongoing review of Scottish contract law.[3]

Principal place of business

We note that the term PPoB is itself unclear, although there are a number of related concepts, such as "head office", "establishment" or "centres of main interest", which are clearer and have been defined in existing legislation.

Ordinary interpretation of the words would lead to the conclusion that this is where most of the business of an entity goes on. In terms of modern business, particularly in terms of services, this interpretation proves problematic. It may be difficult, if not impossible, to determine where the bulk of operations takes place, either because a particular business operates across numerous locations or because staff work remotely or rotate around different offices. Similarly, members of a management team may not all be based in the same location.

Question 5: If a new requirement of a UK-based service address were introduced, but existing operation of the PPoB retained, what if any, transparency requirements should be put in place relevant to the PPoB?

Option B would present an improvement on the current system.

Furthermore, we consider that controls should be put in place to ensure the service address is not merely a "mailbox"; the limited partnership should be expected to respond to eg notices served on it at this address. One option would be to ensure that where an operating office is not maintained within the UK on a permanent basis, the service address would need to be that of a regulated person (ie a firm/organisation/company supervised for AML purposes).

Question 6: Should all limited partnerships be required to file an annual confirmation statement?

SLPs are already required to file an annual confirmation statement under the PSC regulations. Limited partnerships based in other UK jurisdictions are not currently subject to these regulations as they do not have separate legal personality.

The SLP (Register of People with Significant Control Regulations) 2017 require all SLPs or registered agents of to provide:

[3] See the Scottish Law Commission's project page: https://www.scotlawcom.gov.uk/law-reform/law-reform-projects/completed-projects/contract-law-light-draft-common-frame-reference-dcf/

- The SLP name
- A service address for that partnership, and
- Confirmation that it is a general partnership that is a qualifying partnership and is constituted under the law of Scotland.

In relation to each partner in the Scottish qualifying partnership, the information is:

- The partner's full name; and
- If applicable, the register in which it is entered (including details of the state) and its registration number in that register.

Where a partner in an SLP is itself a corporate, the register must look behind the entity (and any subsequent controlling entity) until individual natural persons are identified.

If this were to be expanded, then the answer to this question would depend on what additional information is to be included in the confirmation statement and whether it fulfils a useful purpose and avoids duplication of information which already needs to be submitted.

Question 7: If you are in favour of an annual confirmation statement, what information should be included and who should file it? Please consider whether that should be for the whole partnership or the difference in requirements for general partners against limited partners – including corporate partners.

The general partner of an SLP will already be required to file a confirmation that the firm's registration is accurate. This includes information on partners (both general and limited) capital and any updates to the PSC register (see further our response to question 6 above).

Question 8: Is there a case for limited partnerships to have to prepare accounts and reports in line with the requirements for private companies, as is already the case for qualifying partnerships?

We note that private companies are required to prepare accounts. Introducing such a requirement for limited partnerships might increase transparency and aid investigation regarding their activities, although we note that the accounts filed with Companies House are not particularly detailed.

However, SLPs operate in a different way from companies. Tax transparency means that the SLP itself is not submitted to taxation; it is therefore the partners themselves who must prepare their individual accounts for the relevant tax purposes. Requiring the SLP to prepare separate accounts for submission to Companies House would therefore generate an additional burden, which could also present a barrier to use.

Furthermore, we are not aware of any harm to creditors because no accounts had been filed to date and unless all accounts were audited, it is difficult to see how the filing obligation would help to identify wrongdoing. It is also unclear what would happen with cross-jurisdictional structures.

We also note that UK-based partners are already obliged to file a tax return with HMRC for UK chargeable income and gains. To the extent that submission of accounts can aid in identifying wrongdoing, HMRC therefore already holds this information.

Question 9: Do you agree with the proposal to give the Registrar a power to strike off partnerships from the register of companies?

We agree with the proposal to give the Registrar powers to ensure the accuracy and integrity of registry data, upon which a wide range of business activity is built.

In particular, it would be helpful for limited partnerships (including SLPs) to be able to notify the Registrar when a limited partnership is dissolved and for this to be recorded on the register.

We are concerned that one unintended consequence of striking off a limited partnership is that this would not in fact abolish the partnership relationship per se but would mere serve to remove the limited liability leaving a standard partnership.[4] This could cause serious problems if the register was updated erroneously as partners (both individuals and businesses) could be subjected to unlimited liability. The problem would be compounded where they were unaware of the risk and prolonged if there were not efficient mechanisms in place to reinstate the limited partnership and compensate limited partners for any additional liabilities incurred. A particular problem arises from the fact that the general partner (who/which already has unlimited liability) would bear the practical responsibility for demonstrating that the partnership was still in operation. However, if it failed to meet those requirements, it would be the limited partners which would suffer as their limited liability would be lost.

It would be preferable to mark the partnership on the register as dormant or dissolved as this gives better information to those consulting the register. If a partnership is bogus or fraudulent it would actually be self-defeating to remove from the register: it would aid transparency for this fact to be publicly recorded.

Question 10: Are there any other factors or criteria that the Registrar could consider in order to conclude that the partnership is not carrying on a business or in operation?

We do not consider that the factors suggested would allow the Registrar to correctly conclude that an SLP is not carrying on a business or operation.

[4] See s.2 of the Partnership Act 1890

One common use of the SLP is to hold commercial property or other investments. This is relatively passive, whereas the criteria suggested seem better suited to a business producing goods or selling products or services.

The simplest way to ascertain whether an SLP was still operating would be to seek confirmation from the SLP directly. If no response were forthcoming, then a formal notice process might be instigated with a formal requirement on the SLP to demonstrate that it was still active. As noted above, there is a practical issue to be considered in that the general partner would be expected to respond to such notices and limited partners might not know that these obligations had not been complied with. Serious consequences could arise for those limited partners if the SLP were erroneously struck off, leaving them in a standard partnership with unlimited liability.

Question 11: What operational and legislative procedures could be put in place to mitigate concerns of strike off done in error?

As noted above efficient mechanisms should be put in place to reinstate limited partnerships which have been incorrectly annotated on the register at no cost to the partnership. Limited partners should be deemed to have maintained their limited liability throughout any period where the register erroneously indicated the partnership has been terminated. If striking off procedures had not been properly complied with by Companies House, it should be required to compensate limited partners for any additional liabilities incurred.

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