



Law Society
of Scotland

Call for Evidence Response

Department for Business, Energy & Industrial
Strategy call for evidence: Review of Limited
Partnership Law

March 2017



Introduction

The Law Society of Scotland (the Society) 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 legal 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 legal 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 Call for Evidence has been considered, and the response provided by a Society Working Group which included members of our Obligations, Company, Insolvency and Banking, Technology and Rural Affairs Sub-committees with input from our Financial Compliance Department.

For information we also recently submitted written evidence to the House of Commons Public Bill Committee on the Criminal Finances Bill, which also refers to Scottish limited partnerships.¹

General comments

1. We note that the focus of the call for evidence is towards greater transparency based on the assumption that Scottish limited partnerships (SLPs) are disproportionately being created and used for the purposes of furthering criminal activity. We do not condone the use of any legitimate business structure – such as SLPs – for criminal intent and purposes and we are fully supportive of proportionate, appropriate and directed measures aimed at preventing this. As the professional body for Scottish solicitors we would take robust disciplinary action against any Scottish solicitor convicted of being engaged in a way which facilitates the use of SLPs, or any other business structure, for any criminal activity. However, in considering any proposed measures, care should be taken not to introduce measures which may impose a burden on legitimate businesses but which may not dissuade those business intent on criminal behaviour. We also suggest that the UK

¹ <http://www.lawsco.org.uk/media/1000535/crim-lcm-criminal-finances-bill-lss-written-evidence-january-2017.pdf>

Government liaise with the Scottish Government on the subject of SLPs. Scottish Government ministers are on record as being supportive of initiatives to tackle perceived risks associated with SLPs while preserving the vehicle for legitimate business activity².

2. Partnerships and limited partnerships are very common business entities used for many legitimate purposes. Their operational flexibility and tax transparency (i.e. partners rather than the partnership itself are taxable on partnership activity) are their principal advantages as business entities. In addition, the separate legal personality of Scottish partnerships and limited partnerships can provide extra clarity when operating a business using a partnership. English partnerships and limited partnerships do not have separate legal personality, but are otherwise, the same as Scottish partnerships and Scottish limited partnerships (SLPs).
3. Limited partnerships are a favoured business entity in many types of businesses and sectors, particularly where passive involvement of some participants in the business is important to that business. Accordingly Scottish and English limited partnerships play a central role in the multi-billion pound funds industry both in the UK and worldwide, providing means to connect UK and foreign investors to businesses, shares, property and other assets in which they may wish to invest in the UK and elsewhere.
4. The separate personality of Scottish limited partnerships (SLPs) means that they are particularly useful in this sector as they enable investments to be structured and grouped efficiently. Their status as mainstream business entities and the combined use of Scottish and English limited partnerships can be advantageous. Many jurisdictions worldwide (for example Luxembourg³) seek to promote investment vehicles designed specifically to compete with Scottish (and English) limited partnerships; this is a critical and valuable market and policy makers should note and be conscious of the impact any changes may have on the UK and Scotland's position in that market.
5. Another sector of which policy makers should be aware is the common use of SLPs in agriculture, where a significant number of Scottish farms are tenanted by tenants using such partnerships. As we understand there are currently more than five hundred limited partnership tenancies.⁴ Again the possible unintended effects on this sector of changes that might be made to partnerships should be borne in mind.

² <http://www.scottishlegal.com/2016/08/15/scotland-calls-on-uk-government-to-reform-slps/>

³ Luxembourg limited partnerships – see *société en commandite spéciale*

⁴ *Agricultural Tenancies*, The Right Hon. Lord Gill, 4th ed PARA 6-15 - ISBN: 9780414015012

6. The consultation document refers to criminal activity as the basis for proposed changes. We have been monitoring press reports of criminal activity by SLPs. From those reports it appears that SLPs may be being used to facilitate crimes, such as money laundering and fraud. However, the government needs to provide more evidence of how the extent of alleged criminal activity correlates with the number of limited partnerships created. Limited partnership is one of several business structures available in the UK, all of which have the potential to be used for legitimate or illegitimate purposes. The consultation document does not explain in what way it is considered that SLPs are particularly susceptible to illegal use, or more so than other structures or limited partnerships registered elsewhere in the UK.
7. There is no indication within the consultation document of the financial impact associated with the alleged criminal activity. Without a clear picture of the nuisance complained of, it is difficult to evaluate any proposals to address this and to consider if these would be appropriate and proportionate.
8. We note that the latest published figures for Criminal Proceedings in Scotland⁵ show that prosecutions for crimes of dishonesty (which would include most forms of economic crime, including fraud) have fallen by 36% in the last ten years. Fraud convictions were a full 60% lower than ten years previously. Crimes against public justice (the category likely to include serious organised crime) have increased, but only marginally – a 2% rise against the previous year. It is difficult to ascertain from limited available information as to the number of prosecutions of companies or partnerships in Scotland.
9. We also suggest that there is an apparent tension in focusing on increasing transparency at a time when other legislation is simplifying requirements - i.e. the Private Funds Limited Partnerships order⁶, which removes some of the requirements for disclosure for some partnerships that are collective investment schemes, permits limited partners to do various things without losing their limited liability following several years discussion with the UK funds industry and with a view to its protection and promotion.

⁵ <http://www.gov.scot/Resource/0051/00512934.pdf>

⁶ <http://www.legislation.gov.uk/ukdsi/2017/9780111153208>

10. We further note that the call for evidence makes a number of assertions. For example, it is claimed that the partners of a limited partnership are able to be '*invisible*' and that SLPs are '*run by partners who are unknown to enforcement authorities*'⁷ - these statements require clarification. Any partnership conducting business in the UK under a name which is not the surnames of the individuals who are its partners (or the corporate names of those who are not individuals) is subject to the disclosure requirements of the Companies Act 2006⁸. This includes an obligation to provide information on request, including the name and a service address in the UK for each partner. Failure to comply is a criminal offence. Applying these requirements, we would ask for clarification of how it is possible that partners are either '*invisible*' or '*unknown*'?
11. The Limited Partnerships Act 1907 currently requires the disclosure of more information than is required of a partnership which is not 'limited'. If there is a 'visibility problem' with limited partnerships is it any greater than in other forms of partnership, which may also be used for illegal activities? We suggest that any review should not focus solely on SLPs, but on how *all* relevant legal entities might be used for criminal purposes.
12. While increased 'transparency' is an appropriate objective in principle, we do not believe it should be confined to one form of partnership without good reason. In taking forward any proposal for increased transparency, we would suggest that this must be proportionate and balanced, taking into account and considering the impact of greater transparency on other forms of business structures.

Specific comments and question responses

Q1 - Does the significant increase in Limited Partnerships registered in Scotland bring a similar increase in economic benefit to Scotland? We would be very grateful for the details of the nature of that benefit.

13. We believe that it is difficult to gauge absolute or relative economic benefits without fuller information on the purposes for which SLPs have been used and we suggest that what may amount to 'Economic benefit' does not necessarily derive from the form in which a business is structured, but from its commercial activity. Full consideration of the economic benefits would require the examination of accounts and business information held at Companies House and

⁷ See page 9 Review of Limited Partnership Law – paras 4 & 6

⁸ Companies Act 2006 Chapter 2 - Disclosure required in case of individual or partnership & Chapter 3 Application of general provisions about offences. http://www.legislation.gov.uk/ukpga/2006/46/pdfs/ukpga_20060046_en.pdf

elsewhere, for example with HMRC, from which it would be possible to derive at least prima facie evidence of the purposes for which SLPs have been formed.

14. It may be the case that a significant part of the increased use of SLPs can be attributed to funds structures used throughout the UK and internationally by fund managers based in Scotland, elsewhere in the UK, the USA and in other financial centres. Significant benefits may also arise in Scotland and elsewhere in the UK from advisory and other services relating to the setting up and operation of the partnerships. It is possible that SLPs may have gained ground in funds structures over analogous funds vehicles available in other jurisdictions, such as Luxembourg, Ireland or the Channel Islands. Some of these funds will invest in Scotland and many will invest elsewhere in the UK or more widely globally.

15. In relation to the use of SLPs in farming / rural sector, limited partnerships have been used as a vehicle to enable landlords of agricultural land to provide for tenancies let under the Agricultural Holdings (Scotland) Acts 1949 and 1991. There may be other business reasons to use them but, in our view, this was their primary use in the rural sector. The effect of the Agricultural Holdings (Scotland) Act 2003 is that they are not being used for that purpose due to the rights given to the general partner under the Act. There may be situations where there is a desire on the part of one party to invest in a partnership with limited liability, and such a party may enter into such an arrangement but it is now unlikely that an agricultural landlord and prospective tenant would enter into such an arrangement.

Q2 - Do you have examples, or specific evidence of why Limited Partnerships registered in Scotland have become more popular in the last 5 years than those Limited Partnerships registered in England, Wales and Northern Ireland?

16. See our response to question 1 above. The only real difference between Scottish and other UK partnerships is the separate legal personality of SLPs. For example, in the particular sector of funds, an SLP enables partnerships to be partners in each other and for complex flexible investment structures to be set up using multiple Scottish partnerships. This cannot be done with other UK partnerships and if funds have English partnerships they tend to have a single English partnership at the bottom of the structure. SLPs may be increasing at a higher rate, in relative terms, than elsewhere in the UK, due to increasing complexity of fund structures, but this is hard to verify without further detailed research – which The government should carry out as part of this review.

17. The separate legal personality afforded to partnership by Scots law has obvious practical commercial benefits (the ability to take title to assets and to sue and be sued in its own name) which make it more attractive than English partnerships. Registration under the 1907 Act results in the separation of management from (risk-free) ownership, as in a company or LLP which does not arise in a partnership which is not registered under the Act. The owners (limited partners) play no part in management or in the choice of managers. The regulatory burden on a partnership is significantly less than for a company or LLP. These features will be attractive to businesses where the 'investors' (limited partners) are content simply to derive income and capital value from their interests. We suggest that any constraints on these business models may result in these businesses moving capital and business to another jurisdiction, of which there are a number trying to replicate the Scottish model, to the detriment of the Scottish and UK economies.
18. It should also be borne in mind that separate legal personality is part of the Scots law of partnership (general as well as limited) rather than part of the LP regime - and a part which as with the civil law concept of societies, predates both the 1890 and 1907 Acts.⁹

Q3 - What forms of economic activity or sectors of the economy make the most use of those Limited Partnerships registered in Scotland?

19. A large number of SLPs are used as investment vehicles in various classes of assets, including in Scottish, UK and foreign property, infrastructure and equities – and through private and public equity investment in all parts of the Scottish, UK and broader economies. Investment structures vary greatly in sophistication and investors vary greatly from private individuals and trading companies to UK and foreign public and private sector pension funds and other professional investors.
20. Also there are a significant number of existing SLPs operating in farming. However, we are not aware of new agricultural limited partnerships being created. Economic activity - and growth - in this sector is likely to derive from farming partnerships operating in Scotland, the extent of which is hard to gauge without detailed research, but is thought to remain significant and relatively stable.

⁹ see G J Bell, Principles of the Law of Scotland, 4th edn 1839, § 357

Q4 - What could the UK government do to reduce the potential of Limited Partnerships registered in Scotland being used as an enabler of criminal activity, whilst retaining some or all of the aspects of Scottish Limited Partnership structures which are beneficial?

21. See our general comments above. In addition, we would also suggest that the UK government seek to ensure that anti-money laundering and 'know your client' (KYC) actions are carried out properly by formation agents (those defined as trust and company service providers) - who are regulated by HMRC¹⁰ - forming limited partnerships and by those dealing with them and increasing investigation and enforcement activity accordingly. If criminal use of limited partnerships is thought sufficiently serious, and clear and reliable evidence to support this assumption has been established, then limited partnerships could be subject to formation only by regulated persons making relevant certification on lodging LP5¹¹ forms at Companies House. However, we do recognise that permitting SLP formation only by regulated persons might be restrictive on non-regulated persons who would then be prevented from setting up an SLP for legitimate reasons.
22. Again, it is worth bearing in mind that other business vehicles such as Scottish general partnerships, companies and LLPs also have separate legal personality and that trusts can be used to create very similar effects. Changing the rules on SLPs in isolation would be likely to displace any criminal activity rather than inhibiting it. Proper use of anti-money laundering and KYC actions has the advantage of applying and being relevant across the board, irrespective of the business form.
23. Under the current disclosure obligations there is no requirement to produce detail about the beneficial owners of corporate partners. We suggest that if there is concern regarding SLPs then this may be addressed by the forthcoming register of beneficial ownership. It may be the case that increased scrutiny of beneficial ownership would discourage use of these vehicles for criminal activity without disproportionately prejudicing their legitimate use. Regular updating of that information - which failing, strike off by Companies House - might also be effective.

Q5 - We would like to know whether this basic information requested at the time of registration should be enhanced and if so what additional information might be useful and why? Should there be a requirement to update it at regular intervals?

¹⁰ Money Laundering Regulations 2007, 3(10)

¹¹ Application for registration of a limited partnership.

24. See response to question 4. A change to registered information already requires to be lodged at Companies House. Although it is not normally difficult to trace changes, an annual 'confirmation statement' by limited partnerships similar to that required from companies¹² may be helpful and we do not believe this would be unreasonably burdensome. The requirement to register changes set out in 1907 Act¹³ should be retained. We further suggest that it is important to retain the requirement to declare the amount of each limited partner's contribution to the firm, which cannot be withdrawn¹⁴. We also assume that the need to state 'the general nature of the business' is intended to assure the registrar that a limited partnership intends to comply with the requirement of the Partnership Act 1890 ss. 1 and 45, i.e. to carry on a (lawful) trade, occupation or profession with a view of profit. If this is indeed the case then this should be retained.
25. We would also suggest that it may be helpful to request the addresses of partners - a 'service address'. This might usefully be added to aid due diligence by interested parties. It may be further helpful to amend the current requirement to register 'the principal place of business' to include registration of a 'service address' in the relevant UK jurisdiction (on similar lines to the registered office of a company). The possible unintended consequences of adding a formal UK address in relation to a limited partnership having its principal place of business outside the UK would require to be considered, such as the possibility that a limited partnership operating outside the UK might thereby become subject to UK regulatory regimes for formal rather than substantive reasons.
26. The registrar should be given the resources and where required powers to establish the veracity of the information given in the application to register and subsequent filings.

Q6 - We would like to also consider what levels of transparency would be appropriate to Limited Partnerships, Private Fund Limited Partnerships and Limited Partnerships registered in Scotland?

27. We see no reason for rules to be different for SLPs than for English limited partnerships. Accounts lodged by limited partnerships with corporate partners provide information additional to basic information provided on forms LP5¹⁵ and LP6¹⁶. The Private Fund Limited Partnership rules¹⁷ coming into force will alter information provided and it is not clear how policy here interacts with

¹² Companies Act 2006 s. 853A

¹³ Companies Act 2006 section 9(1)

¹⁴ Partnerships Act 1907 section 4 We note that the Review document (page 11) incorrectly states that this applies to all partners

¹⁵ Application for registration of limited partnership

¹⁶ Statement specifying the nature of a change in the limited partnership

¹⁷ <https://www.gov.uk/government/publications/legislative-reform-order-to-change-partnership-legislation-for-private-equity-investments>

possible application under discussion of the persons of significant control regime to limited partnerships - where there seems little reason to apply the regime, particularly to limited partners, who have a passive role.

Q7 - What are the costs of registering a Limited Partnership /Scottish Limited Partnership under the current regime?

28. We are not in a position to advise on the aggregate net cost of registering a Limited Partnership /Scottish Limited Partnership under the current regime. This will depend on the extent of costs for any professional service that may have been retained and are associated with the creation of the business entity. However, the registrar's fee for registration (other than 'same day') is £20.¹⁸

Q8 - What would the costs be of enhancing the regime to include more transparency requirements - for example annual reporting of accounts, re-confirming identities of partners or principal place of business?

29. We are not in a position to comment on the costs. We suggest that if changes of this nature are significantly onerous this may result in legitimate businesses moving capital and business to another jurisdiction, of which there are a number trying to replicate the Scottish model, to the detriment of the Scottish and UK economy. However less onerous requirements, in our view, should not greatly impact.

Q9 - Do you have any evidence that increased regulatory requirements would have an adverse effect on legitimate use of Limited Partnerships registered in England, Wales, Northern Ireland and Scotland?

30. This depends on the extent of increased regulatory requirements. Without further information about the proposals, it is difficult to constructively respond. However, other jurisdictions¹⁹ are already competing hard for their own business structures, similar to SLPs to be used in the UK and elsewhere as funds vehicles in place of SLPs and administrative burdens and costs are factors in that competition.

¹⁸ (SI 2008/2392).

¹⁹ For example, Luxembourg limited partnerships – see société en commandite spéciale

Q10 - We would welcome views on whether this level of transparency is adequate for Limited Partnerships, Private Fund Limited Partnerships and Limited registered in Scotland.

31. Except for recent media reported use of SLPs for criminal purposes, we are not aware of transparency problems arising relative to SLPs. As with other entities, those dealing with limited partnerships normally require significant levels of current information to be provided as part of due diligence, KYC etc. We believe the changes to 'transparency' suggested above would be adequate.

Q11 - Would this level of transparency have any adverse effects on Limited Partnerships or Limited Partnerships registered in Scotland, and if so, what might they be?

32. See our response to question 8 above.

Q12 - Given that formation agents are already subject to money laundering regulations, should there be any additional requirements placed on these entities? If so, what should these be?

33. We suggest a requirement that formation agents register with HMRC as such, if they are not otherwise previously registered or regulated. We also suggest that formation agents- who are not otherwise regulated (such as solicitors) undergo formal training, and ongoing annual CPD, on money laundering regulations and be subject to assessment to demonstrate fitness to provide the service they offer. There should be no ability to provide formations services without such assessment. The Money Laundering Regulations 2007, 3(10) defines trust and company formation service providers, and regulation 23(1)(a)(ii) provides that they are regulated by HMRC. This does not include Scottish solicitors who are regulated by the Law Society of Scotland. Therefore we suggest that HMRC, if they are not already doing so, should take a lead on ensuring formation agents are suitably trained and assessed.

34. Scottish solicitors who may undertake company formation as an ancillary service to clients - are already subject to formal training and assessment / audit via (i) CPD, (ii) targeted and routine inspection, and (iii) bi annual (2 x per year) submission of a certificate confirming (among other things) AML compliance.

35. As with question 4, a balance may need to be struck between restricting the number of types of person who can register an SLP as against any prejudice to legitimate business people.

36. We also suggest that it may be helpful for a requirement on the part of Companies House to report to HMRC when the same agent acts in the formation of 2 or more SLPs.

Q13 - Why is it important for a Limited Partnership or Limited Partnership registered in Scotland to be able to move all of its activities outside of the UK whilst still being governed by UK legislation?

37. This will depend on the business and economic purpose of the SLP. However, there is no reason why the position for limited partnerships and SLPs should be different than it is for companies. The UK legislation relates to the constitution of the entity and restrictions that threaten the stability of a partnership's constitution seriously undermine its viability as a business entity. In addition, there is no reason in principle why Scotland as another well-regulated jurisdiction should not provide business entities for international use – particularly in cross-border activities. The business environment otherwise risks being perceived as inward-looking and parochial.

Q14 - What benefit does a UK registered Limited Partnership or a Limited Partnership registered in Scotland bring to the UK if its Principle Place of Business and all of its activities are outside of the UK?

38. See above at para 36- re companies – though there is no reason in principle why a SLP (like a Scottish company) could not have a registered office in Scotland distinct from its principle place of business.

Q15 - What would be the impact of requiring a Limited Partnership or Limited Partnership registered in Scotland to maintain some form of presence within the UK at all times?

39. This will depend on the level of presence required. It can be the case that the location of business activity varies from time to time for many businesses. Requiring, for example, a European equity fund to hold some investments in Scottish companies at all times would deter the use of a SLP as a vehicle for such a fund even if it was likely to hold Scottish equities most of the time.

Q16 - We would also be interested in views on whether a Limited Partnership or a Limited Partnership registered in Scotland should be struck off the register if there are convictions against the partners or the entity for illegal activity.

40. The question appears not to take into account and give due weight to the separate personality of an SLP. We would suggest that it may not necessarily be equitable to strike of an SLP due to proven

criminal activity by a single partner. We suggest that a more suitable approach and remedy would be for the relevant authority to petition the court for the firm's dissolution in the public interest along the lines of Insolvency Act 1986²⁰. Such a process has inbuilt safeguards for innocent partners, employees, creditors and others.

41. It is perhaps worth noting that the suggestion within the question bears little relation to the text immediately preceding it in the consultation. There is no necessary connection between illegal activity by a partner and dissolution which is not followed up on the register. The latter may not have any criminal element.
42. A more clearly expressed duty on the part of partners to winding up an LP and register dissolution in the 1907 Act may help. In relation to illegal activities by partners, it is also worth bearing in mind that s 35 of the 1890 Act makes provision for partners – so long as they are not involved in the alleged criminal activity- to seek dissolution in the case of relevant criminality – so long as they are not involved in the alleged criminal activity- and that, if a firm's business is illegal, then either there will be no valid partnership (and thus no valid SLP) formed (in the case of initial illegality) or the firm will be dissolved (in the case of supervening illegality, 1890 Act s 34).
43. Care is required for limited partners not involved in criminality. In the context of limited partnerships and agricultural tenancies, the effect of striking off the partnership would mean the tenant ceases to exist and therefore the general partner, who is the party actually carrying out the farming, ceases to have the right to be on the farm.

Q17 - The UK government would also welcome views on the real impact of striking off a legitimate Limited Partnership or Limited Partnership registered in Scotland without the knowledge of the partners and what could be done to mitigate any adverse impact.

44. We believe that this would be seriously detrimental to the willingness of limited partners to use SLPs. In addition, striking off a limited partnership or SLP without the knowledge of its partners may adversely impact, not only on the partners but also on third parties dealing with it.

²⁰ Insolvency Act 1986 section 124A - Petition for winding up on grounds of public interest

45. Striking off a limited partnership is not the same as striking off a company. It merely removes the limited liability of limited partners and will not dissolve the partnership – which would remain as an ordinary partnership (as no formality is required to form a partnership). All that registration of a partnership as a limited partnership does in the first place is to confer limited liability on the partners.
46. However, where there is reasonable cause to believe a limited partnership is engaging in a criminal activity and not carrying on a legitimate business, it should be possible to dissolve and remove a limited partnership registered in any UK jurisdiction. The procedure, safeguards and the possibility of restoration could, we suggest, be modelled on that applicable to companies under Part 31 Companies Act 2006.
47. We would emphasise that in the context of limited partnerships and agricultural tenancies, as we stated at para 42, the effect of dissolving the partnership would mean the tenant ceases to exist and therefore the general partner, who is the party actually carrying out the farming, ceases to have the right to be on the farm. Effectively a tenant farmer (the general partner) would be dispossessed of his tenancy without the limited protection which the Agricultural Holdings (Scotland) Act 2003 gives to a general partner in the event of termination of a limited partnership by the application of its contractual terms.

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