

LLP - Partnership Tax Changes 2014 Finance Bill

Earlier this year, HMRC published a consultation document setting out the proposed changes to two particular aspects of the partnership tax rules. The draft Finance Bill 2014, published on 10 December 2013, sets out the detail of these proposed changes following the consultation.

These measures are intended to prevent a loss in tax revenue arising from what HMRC calls 'disguised employment' relationships, using Limited Liability Partnerships (LLPs), and also from certain arrangements that HMRC believes are designed to manipulate profit and loss allocations in order to achieve a tax advantage.

This paper focuses on the new 'disguised employment' measures. A separate paper has been prepared on the changes for 'mixed membership' partnerships (broadly, where the partnership consists of both individual and non-individual members) where the profits/losses of the partnership are reallocated among the members in order to achieve a tax saving.

Disguised Employment

At present, HMRC's view is that there is a legal presumption that individual members of an LLP are taxed as self-employed partners and, as a result, subject to what HMRC refers to as a more favourable income tax and National Insurance contributions (NIC) treatment.

The consultation earlier this year, proposed to remove any presumption of self-employment and to set out tests to determine whether an individual was really an employee or "salaried member".

The original proposal was to use the existing employment status tests handed down by the courts or to introduce tests based on risk and reward, however the draft finance bill 2014 highlights that the actual tests to be introduced will be much more draconian

Measures Introduced

An individual who meets the conditions of a salaried member will be treated for UK income tax purposes as an employee of the LLP and, therefore, as liable to PAYE and employee's Class 1 NIC.

As an employer, the LLP would be liable to employer's Class 1 NIC on remuneration paid (currently at 13.8%). Salaried members would also be included in the benefit in kind rules. The salaried member would not however get employee law protection.

The Tests

A member of an LLP will be classed as a salaried member rather than a self-employed partner if all of the following three conditions are met:

- *The first condition is that the individual performs services for the LLP in the capacity of a member and it is 'reasonable to expect' that the amounts he or she receives in return are "wholly or substantially wholly, disguised salary". Here a payment is disguised salary if it is a fixed amount, or a variable amount that is not in practice affected by the overall profits or losses made by the LLP.*

- *The individual does not have 'significant influence' over the affairs of the LLP.*
- *The individual's capital contribution to the LLP is less than 25% of the disguised salary which the LLP is reasonably expected to pay the individual in a relevant tax year. This test requires further consideration where there are changes in the individual's capital contribution during the year or there is another change in circumstances.*

An anti-avoidance provision is also going to be introduced, which means that any arrangement with a purpose of circumventing the rules will be disregarded.

Mixed Partnerships

With reference to mixed partnerships of individual and corporate members, the legislation will for tax purposes reallocate excess profits from a non-individual partner to an individual partner where the following conditions applied:

- *A non-individual partner has a share of the firm's profit;*
- *The non-individual's share is excessive;*
- *An individual partner has the power to enjoy the non-individual's share or there are deferred profit arrangements; and*
- *It is reasonable to suppose that the whole or part of the non-individual's share is attributable to that power of arrangement*

HMRC has also restricted the ability to allocate income and capital losses between individuals and non-individual partners where it is tax-motivated.

HMRC will also seek to reallocate profits if it is seen as more than just and reasonable, which is in essence more than:

- *An appropriate notional return on capital; and*
- *An appropriate notional consideration for services*

By introducing the changes on **6 April 2014**, rather than allowing firms to implement the changes in the first accounting period following 6 April 2014, these changes will result in unnecessary complexities for firms and could have been avoided.

Our view is this may now give the partnership model a very real disadvantage in comparison to the traditional Limited Company Model

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