Government confirms crackdown on LLP taxation

The Chancellor confirmed in yesterday’s Autumn Statement the Government’s plan to remove the presumption of self-employment from limited liability partnerships and to counter the artificial allocation of profits to partners.

As we reported at the time of the Budget, the proposed changes are of particular interest to the investment management industry, lawyers, accountants and construction professionals practising as LLPs.

The full text of the Autumn Statement sets out that it expects the measures to yield £3.27 billion in taxation:

“At Budget 2013, the government announced a review of partnerships primarily to counter the use of limited liability partnerships to disguise employment relationships and the tax-motivated allocation of business profits to corporate partners, which are generally taxed at lower rates than individuals. During the consultation, the government received new information showing the impact on alternative investment fund managers who operate as partnerships will be greater than anticipated. The government is confirming that it will take forward these proposals and the expected yield from the measure has now increased to £3.27 billion from 2013-14 to 2018-19.”

The changes are due to be introduced from 6 April 2014, when HMRC plans to judge Members by two conditions:

1. A salaried member of an LLP is an individual member of that LLP who, on the assumption that the LLP member is carried on as a partnership by two or more members of the LLP, would be regarded as employed by that partnership.

   HMRC will apply their normal employment status tests to see whether this condition applies. Even if the member passes the first test, then the second will be applied:

2. A salaried member of an LLP includes an individual member of the LLP who does not meet the first condition but who:

   (a) has no economic risk (loss of capital or repayment of drawings) in the event that the LLP makes a loss or is wound up;

   (b) is not entitled to a share of the profits; and

   (c) is not entitled to a share of any surplus assets on a winding-up.
Given that many of those affected are likely to be accountants and solicitors, HMRC is wise to firms seeking to avoid the second condition. Any risk or entitlement will be ignored if, having regard to all the circumstances and in particular the total economic rewards available or likely to be available to the member, it is reasonable to regard the risk or entitlement as insignificant.

What is insignificant? HMRC’s view is that an entitlement to share in profits that for practical purposes would never be more than 5% of any fixed entitlement would be unlikely to be regarded by HMRC as significant. HMRC will be concerned if taxpayers tried to circumvent the proposed changes that were intended to have no practical effect other than to disapply the legislation. A targeted anti-avoidance rule will be introduced to prevent such arrangements. How such a measure would discriminate between legitimate and abusive tax planning is entirely unclear.

If a member is judged to be a salaried member, then that person will be treated in relation to their work for the LLP as an employee for both income tax and national insurance purposes (including benefits in kind). One unintended consequence might be that a tier of formerly self-employed members is able to claim employment rights against their employers.

LLPs should undertake a review now to identify whether any of their members might be classed as “salaried members”. If there is a risk, then legitimate steps might be possible to restructure partnership arrangements to avoid falling foul of the rules.

We shall publish guidance on the Government’s proposals as soon as further information becomes available.

If you have any queries regarding the Government’s proposed changes, or on LLPs in general, please contact:

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