

February 2014

## PARTNERSHIPS & LLPs

### IMPORTANT CHANGES FROM 6 APRIL 2014



Finance Bill 2014 will introduce new legislation in regard to partnerships.

There are two main changes that are due to take place; the treatment of salaried members in a Limited Liability Partnership (LLP), and a change in the tax treatment of partnerships with mixed membership.

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#### Limited Liability Partnerships; Treatment of Salaried Members

From 6 April 2014 legislation will be introduced to change the treatment of a salaried member of an LLP from that of a partner to that of an employee, for both tax and national insurance purposes.

The new rules will apply when three conditions are met (the Salaried Member Test), therefore, in order for these rules not to apply you need to ensure that at least one condition is not met. (The salaried member provisions do not apply to companies or individuals who do no more than invest money).

The conditions are:

##### *Condition A – Disguised Salary*

Condition A applies where a member is wholly or substantially rewarded for their performance of services to the LLP either through a fixed salary, or a variable amount, calculated without reference to the overall profitability of the business.

For this purpose 'substantially' is defined as 80% or more.

##### *Condition B – Lack of Significant Influence*

This condition applies where a member does not have a significant influence in the affairs of the business as a whole. Responsibility for running a department, or specific area of the business only, will still result in the satisfaction of this condition.

##### *Condition C – Capital Contribution*

An individual will be considered a salaried member under condition C where their capital contribution is less than 25% of the reasonably expected disguised salary, as defined above in condition A.

Please note that for this purpose undrawn profits, tax reserve accounts, and personal guarantees are not considered, whilst any arrangements where the main purpose is to prevent the disguised employment rules from applying are also ignored.

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## Partnerships with Mixed Membership

Finance Bill 2014 will also introduce new rules for mixed partnerships, allowing HM Revenue & Customs (HMRC) to reallocate profits and losses between partners to prevent tax-motivated allocations.

These rules will affect all types of partnership where, as well as individual partners, there are also non-individual partners (i.e. a company, trust or LLP). The rules take place from 6 April 2014, whilst anti-avoidance provisions were introduced with effect from 5 December 2013.

The legislation does not apply to mixed member partnerships in which the individual and non-individual partners are genuinely acting at arm's length.

### *Excess Profit Allocation*

The excess profit allocation rules apply where a non-individual partner has a share of the firm's profits, representing either deferred profit of the individual, or excessive profits in relation to capital contribution or services performed, which an individual has power to enjoy. As a result of such arrangements an individual's profit share and relevant tax amount will be lower than it would have been had the profits been allocated to the individual.

Where the rules apply, the profit sharing arrangements set out in the partnership agreement will be over-riden and profit will be reallocated on a 'just and reasonable basis'. The reallocated profits will be taxed on the relevant individual(s), however, please note that that profits remain in the hands of the non-individual partner, but can be passed to the individual without further tax becoming due.

### *Excess Loss Allocation*

In addition, the new legislation allows income and capital loss reliefs to be restricted, or denied where a loss is allocated to an individual where one of the main purposes is tax avoidance.

## Considerations before 5 April 2014

All partnerships should review their existing partnership agreements before 5 April 2014, and speak to their usual contact(s) at Beavis Morgan regarding the potential impact of the above legislation to their business.

There are a number of steps that can be considered for either mixed partnership, or LLPs with salaried members. These include:

- Outright incorporation. This would act to remove the partnership structure at target in the legislation, with the business instead becoming a corporate entity.

### *Limited Liability Partnerships; Treatment of Salaried Members only;*

- Review profit arrangements; variable allocation based on the profitability of the whole firm, with built in repayment clauses.
- Amend LLP agreement to vary voting arrangements to give all members significant influence over the affairs of the businesses as a whole.
- Require capital contribution from members equivalent to at least 25% of likely remuneration.

### *Partnerships with Mixed Membership only;*

- Remove the corporate members, conceding to the full impact of the new rules
- Establish a corporate subsidiary from which to operate the business
- Provide the corporate member(s) with profits that can be justified in relation to the services provided or provision of capital.

**The new rules are widely defined and it is expected that they will affect a large number of partnerships. It is, therefore, important that action is taken now, before 5 April 2014, to determine what the implications will be for your own business and what steps can be taken to mitigate the impact of the rules.**