



CUMMINGS

lawyers for alternative investments

HMRC taxation  
of Partnerships  
and LLPs



# HMRC taxation of Partnerships and LLPs

## Introduction

As widely expected, it was announced in the Autumn Statement 2013 that legislation would be introduced in the draft Finance Bill 2014 affecting the taxation of partnerships and LLPs.

These changes will require all LLPs to review their LLP deeds and work with lawyers to put in place suitable amendments to the arrangements they contain.

This follows an HMRC consultation published in May 2013 on changes to two aspects of the partnership tax rules: (i) salaried partners; and (ii) mixed memberships. The consultation was drawn up in response to the Government's announcement in the 2013 Budget that it was proposing to change the tax rules in line with its principles and objectives for fairness and flexibility in the tax system.

In addition to the above, the draft Finance Bill 2014 will also introduce legislation for setting up a collection mechanism for partnerships and LLPs operating as AIFMs under the AIFMD.

The above three changes introduced by the Finance Bill 2014 can be summarised as follows:

### 1. Tax-motivated allocation of profits or losses in mixed membership partnerships

Under the Finance Bill 2014, legislation will be introduced to counter tax-motivated allocations of business profits or losses in partnerships and LLPs where the partners include both individuals and companies.

There are two parts to the legislation, namely:

- (i) measures aimed at mixed membership partnerships where partnership profits are allocated to non-individuals in circumstances where an individual member may still benefit from those profits; and

- (ii) measures aimed at cases where partnership losses are allocated to an individual member, instead of a non-individual member, to enable the individual member to access certain loss reliefs.

With regard to (i), the legislation will introduce measures which will re-allocate the excess profits allocated to a corporate member to an individual member instead where the following conditions are met:

- (a) the corporate member has a share of the firm's profits;
- (b) the corporate member's share is excessive;
- (c) an individual member has the power to enjoy the corporate member's share or there are deferred profit arrangements in place; and
- (d) it is reasonable to suppose that the whole or part of the corporate member's share is attributable to that power or arrangements set out in (c).

Where the rules apply, the individual member's profit allocation will be increased on a just and reasonable basis.

The legislation will include provision for excess profits to be re-allocated to an individual who is not a member if it is reasonable to suppose both that the individual would have been a member but for the new rules and that the whole or part of the corporate member's share is attributable to that individual's power to enjoy the corporate member's share or to deferred profit arrangements.

With regard to (ii), legislation will be introduced to deny certain income tax loss reliefs and capital gains relief for a loss allocated to an individual member. This will be the case where the individual member is party to arrangements, the main purpose(s) of which is to secure that some or all of the loss is allocated to the individual



member, instead of the corporate member, with a view to the individual obtaining relief.

## 2. Treatment of salaried members

In its consultation, HMRC addressed the issue of 'salaried members' i.e. those members working for an LLP on terms that were tantamount to employment. It had been expected that HMRC would seek to challenge the long held presumption that a partner or member is self-employed for tax purposes. However, the Finance Bill 2014 has not removed this presumption, but has introduced provisions to change the treatment of a salaried member from that of a member to that of an employee where the following three conditions are met:

- (i) there are arrangements in place under which the member will perform services for the LLP and it is reasonable to suppose that payments by the LLP to the member will be wholly or substantially wholly 'disguised salary'. Payments are disguised salary if they are fixed, or if variable, variable without reference to or in practice unaffected by the overall profits and losses of the LLP;
- (ii) under the terms of the agreement between the members and the LLP, the member has no significant influence on the affairs of the LLP; and
- (iii) the member's contribution to the LLP is less than 25% of the disguised salary which it is reasonable to expect that the LLP will pay to the member in the relevant tax year.

All three conditions have to be met for the rules to apply. The new rules will also apply to an individual providing services to the LLP via a corporate member of the LLP.

Where the rules apply, an individual member will be treated as an employee for tax purposes and will be required to pay the appropriate tax and NI contributions accordingly. Employers NI contributions will be payable by the LLP and the costs of employing the salaried member will be deductible from the LLP's profits.

## 3. AIFMs and deferred remuneration

The legislation will allow partners and members of partnerships and LLPs which are AIFMs to allocate certain 'restricted' profits to the partnership or LLP. These are profits that the individual is unable to immediately access because of requirements under the AIFMD to defer certain remuneration of key staff.

The legislation will provide as follows:

- (i) it will allow any partner or member to allocate all or part of their 'relevant restricted profit' to the firm. Relevant restricted profit is held to be deferred remuneration (within the meaning of the AIFMD) plus any remuneration which is awarded in the form of instruments that must be retained for a period of at least 6 months;
- (ii) where profits are allocated in this way, the partnership or LLP will pay tax at the additional rate of tax (currently 45%) on that income, with no reliefs or allowances to be available to be set against it;
- (iii) where the profits vest and the individual is able to access them, these will be treated as taxable income of the individual for that tax year with an associated credit of the tax already paid by the partnership or LLP;
- (iv) if the profits do not vest in the individual, the payment will be treated like any other partnership distribution. There is no mechanism for the tax to be repaid; and
- (v) where the deferred remuneration is awarded in the form of instruments which vest in the individual, the individual is treated as acquiring the instruments for an amount equal to the deferred profit net of income tax paid.

The firm must elect for these provisions to apply for this allocation of restricted profits to be permitted.



## Timing

All of these changes are due to come into effect on 6 April 2014, with the exception that the anti-avoidance rules concerning profit allocation set out in paragraph 1 are intended to apply from 5 December 2013.

The tax changes will affect the agreements which partnerships currently have in place and we recommend that firms review their partnership deeds with lawyers as soon as possible.

Cummings Law is able to advise on any necessary changes which need to be made.

If you would like to discuss this further, please contact Claire Cummings at [Claire.Cummings@cummingslaw.com](mailto:Claire.Cummings@cummingslaw.com) or on 020 7585 1406.

**This document is for general guidance only. It does not constitute advice  
January 2014**



42 Brook Street, London W1K 5DB +44 20 7585 1406 | Neuhofstrasse 3d, CH-6340 Baar +41 41 544 5549

Regulated by the Solicitors Regulation Authority