



## **Partnerships Review: Class 4 contributions and limited liability partnerships (salaried members)**

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### **Who is likely to be affected?**

Class 4 contributions (AIFMs): Alternative investment fund managers operating through partnerships including limited liability partnerships (LLPs) and their members who will defer the distribution of profits to members in accordance with the AIFMD rules. AIFM firms that operate as companies are not affected.

Limited liability partnerships (salaried members): LLPs and their members who meet certain criteria (to follow those to be set out in Finance Bill 2014 legislation) to ensure that those engaged on terms akin to employment (salaried members) are treated as employees for the purposes of NICs.

### **General description of the measure**

The Partnerships Review measure has two strands: the first deals with "Disguised Employment" while the second seeks to counter tax-motivated "Profit & Loss Allocation Schemes". Separate TIINs will be published alongside draft tax legislation in the autumn for this measure. This note focuses on two proposed changes to the NICs rules arising out of the measure.

i) Disguised employment through the use of LLPs - proposed changes will prevent LLPs and their members from benefitting from the default partner status of all individual members by disapplying the presumption of self employment and ensuring that LLP members who meet defined conditions are treated as employees or salaried members for income tax and national insurance purposes.

ii) Profit deferral under the AIFMD: the interaction of the AIFMD and current tax rules means that partners will be subject to tax and national insurance on certain profits they cannot access in the base year because these profits will be deferred to 3-5 years in accordance with the AIFMD rules. It is proposed that a statutory mechanism will be introduced to address this issue without allowing the continued use of corporate partners as this would give rise to tax advantages which the second strand of the partnerships measure will prevent. As part of this statutory mechanism, it is proposed to introduce a power that will allow changes to be made to the NICs rules to facilitate this mechanism.

### **Policy objective**

The objective for the first change is to achieve a fairer system, ensuring that those who should pay tax and NICs as employer and employee do not avoid this responsibility by disguising the nature of the employer/employee relationship behind an LLP. It ensures a level playing field between employers.

The objective for the second change is to provide a statutory mechanism to enable AIFM firms which operate as a partnership to comply with the AIFMD rules without their individual partners being subject to tax and national insurance on profits that they cannot access in the base year.

## **Background to the measure**

HMRC published a consultation document on 20 May 2013 with proposals for addressing the disguising of the employer/employee relationship through membership of a LLP and for countering schemes to reduce income tax through manipulation of profit and loss sharing arrangements (Partnerships: A review of two aspects of the tax rules). The consultation closed on 9 August.

During the consultation, the Government received further information about a tax issue that can arise from the interaction of the AIFMD and the existing partnership tax rules on those alternative investment fund managers who operate as a partnership. Following discussions with sector representatives, the Government has decided to recommend to Parliament the introduction of a statutory tax mechanism for addressing this issue as part of the partnerships changes. Both new tax and NICs legislation required for this mechanism will take effect from 6 April 2014, alongside the new legislation required to tackle disguised employment through LLPs and other changes to be introduced under the partnerships review.

## **Detailed proposal**

### **Operative date**

The measure will have effect from 6 April 2014.

### **Current law**

Class 4 contributions (AIFMs): Individual members of partnerships (including LLPs) are charged to tax on their trading profits as they arise under Chapter 2 of Part 2 ITTOIA 2005. Those profits are also subject to Class 4 NICs in accordance with Section 15 SSCBA 1992.

LLPs (salaried members): Currently, all individual members of trading LLPs are treated as self employed for income tax and national insurance purposes (sections 863 ITTOIA and section 15 (3A) Social Security Contributions and Benefits Act 1992).

### **Proposed revisions**

Class 4 contributions (AIFMs): a new power, to be based on tax legislation to be introduced under Finance Bill 2014, will be included in this Bill that will allow regulations to be made to enable the statutory mechanism to be implemented. This will allow alternative investment fund partnerships to comply with the AIFMD rules in a way that would not result in individual partners paying tax on partnership profits that they cannot access in the base year. The power will also allow further changes to be made to the NICs legislation by regulations in future if the tax legislation changes.

LLPs (salaried members): a new power will also be provided in the Bill and this will allow HMT to reclassify certain LLP members as employed earners for NICs purposes when certain conditions are satisfied. The conditions will follow those set out in income tax legislation to be introduced under Finance Bill 2014 and will broadly be that the individual member of the LLP has no or little real economic interest or risk in the LLP and instead will be rewarded by a fixed salary.

The powers under this new clause will additionally allow the Treasury to counteract the use of companies or other intermediary structures to avoid the impact of the measure.

## Summary of impacts for the Partnerships Review

The following table is a summary of full impacts for the partnership review announced in Budget 2013.

<b>Exchequer impact (£m)</b>		2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	Budget	nil	+125	+365	+300	+285	+270
	Extra	nil	nil	+680	+430	+410	+400
	Total	nil	+125	+1,045	+730	+695	+670
	<p>The first row presents the figures published at Budget 2013 that were set out in Table 2.1 of the Budget Report and certified by the Office of Budget Responsibility (OBR) at that time. More details about the original figures can be found in the policy document published alongside the Budget.</p> <p>The second row presents the extra costing attributable to the alternative investment fund management (AIFM) sector and has been estimated using information gathered during the consultation carried out over the summer. These figures are set out in Table 2.1 of the Autumn Statement 2013 and have been certified by the OBR. The policy document published alongside the Autumn Statement provides further details.</p>						
<b>Economic impact</b>	<p>This measure will result in a more level playing field through reducing distortions to competition and to the allocation of resources among sectors driven by tax planning. It may also result in an increase in labour costs and a decrease in post-tax profits levied on selected partnerships in certain industries. Overall, the impact on the economy should be small.</p>						
<b>Impact on individuals and households</b>	<p>Those individuals who are affected members of partnerships will now be required to pay the correct amount of tax and NICs at broadly the right time. It is possible that there is a modest reduction in administrative burden for some individuals who will pay through PAYE rather than having to fill in a self assessment return. Overall the impact is expected on individuals and households to be negligible.</p>						
<b>Equalities impact</b>	<p>No impact is expected on any protected equality groups.</p>						
<b>Impact on businesses including civil society organisations</b>	<p>This measure will have a negligible impact on businesses and civil society organisations.</p> <p>The existing evidence suggests that the majority of partnerships will not be affected by the consultation proposals. Those partnerships affected are likely to be limited in number and they are primarily large professional or AIFM partnerships.</p> <p>There would be some one off costs as professions and taxpayers need to understand the new rules and communicate them to their partnership members.</p> <p>For those AIFM partnerships which choose to use a new paper-based process to account for tax and NICs, administrative costs are expected to be negligible as they are already required to record and process the information in order to comply with the regulatory and tax requirements.</p>						

<b>Operational impact (£m) (HMRC or other)</b>	The operational costs of these NICs changes are expected to be negligible.
<b>Other impacts</b>	Other impacts have been considered and none has been identified.

### **Monitoring and evaluation**

The partnerships review measure will be monitored and assessed alongside other measures in the Government packages for fairer taxation and avoidance.

### **Further advice**

If you have any questions about this change, please contact James Ewington on 03000 553788 (email: [partnership.review@hmrc.gsi.gov.uk](mailto:partnership.review@hmrc.gsi.gov.uk)).

### **Declaration**

David Gauke MP, the Exchequer Secretary to the Treasury, has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.