

EXPLANATORY NOTE

PARTNERSHIPS (PART 1): LIMITED LIABILITY PARTNERSHIPS – TREATMENT OF SALARIED MEMBERS

SUMMARY

1. Clause [a] and Schedule [b] remove the presumption of self-employment for some members of limited liability partnerships (LLPs) to tackle the disguising of employment relationships through LLPs.

DETAILS OF THE SCHEDULE

2. Paragraph 1 inserts new sections 863A to 863G into Part 9 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

3. Subsection (1) of new section 863A provides that the consequences in subsection (2) apply at any time when conditions A to C are met in the case of an individual (“M”) who is a member of an LLP to which section 863(1) of ITTOIA 2005 applies. Conditions A, B and C are detailed in new sections 863B, 863C and 863D respectively.

4. Subsection (2) of new section 863A provides the consequences if the circumstances and conditions in subsection (1) are met. It explains that M is to be treated as being employed by the LLP under a contract of service, instead of being a partner, and that, accordingly, M’s rights and duties as a member of the LLP are to be treated as arising under that contract of service.

5. Subsection (1) of new section 863B details the times at which condition A needs to be considered. These are the 6 April 2014 or, if later, when M becomes a member of the LLP (if relevant arrangements are in place at those times). Otherwise, the time is any subsequent time when relevant arrangements are put in place or changed, or the time when relevant arrangements for a relevant period were expected to be modified or end but in fact they carry on. These are each a “relevant time”.

6. Subsection (2) of new section 863B defines the term “relevant arrangements”.

7. Subsection (3) of new section 863B uses a 2 step process to determine the question whether condition A is met at a relevant time.

8. Step 1 requires the identification of the relevant period. This is the period beginning with the relevant time and ending when it is reasonable to expect that the relevant arrangements for the period will end or be changed. The relevant arrangements for the period are those in place at the relevant time.

9. Step 2 provides that condition A is met at the relevant time if it is reasonable to expect that at least 80% of the total amount payable by the LLP for M's performance, during the relevant period, of services for the LLP, in M's capacity as a member, will be disguised salary. The term "disguised salary" is defined in Step 2.

10. Subsection (4) of new section 863B provides that the determination of whether condition A is met at the relevant time continues until such time as the question has to be re-determined because of a change to the relevant arrangements or the end of the period for which the condition was considered.

11. Subsection (5) of new section 863B defines "arrangements" for the purposes of new section 863B.

12. The application of condition A and the process of determining if the condition applies is illustrated in the following example.

13. Example 1: M becomes a member of an LLP on 1 July 2014 and arrangements are made that in return for working for the LLP M will receive a fixed salary for the period 1 July 2014 to 30 June 2015. It is expected that a new annual arrangement will be put in place from 1 July 2015.

14. The relevant time at which condition A is to be determined is the 1 July 2014 being the date when M became a member and the relevant pay arrangements were put in place. The relevant arrangements are the pay arrangements for the period 1 July 2014 to 30 June 2015. The relevant period is 1 July 2014 to 30 June 2015. The latter date being the date on which it is expected that the arrangements will end. M's services is the work that M will do for the LLP in the capacity as a member in the period 1 July 2014 to 30 June 2015.

15. On 1 July 2014 it is expected that M will receive a fixed salary for the period 1 July 2014 to 30 June 2015. It is therefore reasonable to expect that at least 80% of the amount payable for M's services under the arrangements in place for that period will be disguised salary and condition A will be met. The determination will apply until the end of the 30 June 2015 unless the arrangements change during the period.

16. New section 863C details condition B which is that M does not have significant influence over the affairs of the LLP.

17. Subsection (1) of new section 863D details condition C which is that, at the relevant time, M's contribution to the LLP is less than 25% of the amount specified by subsection (2).

18. Subsection (2) of new section 863D details the amount that is to be taken into account for the purpose of subsection (1). This is the total amount of disguised salary which, it is reasonable to expect, will be payable by the LLP for M's performance, during the relevant year, of services for the LLP in M's capacity as a member of the LLP. It also explains the meaning of "the relevant tax year" and that "disguised salary" has the meaning given in paragraphs (a) to (c) at Step 2 of new section 863B(3).

19. Subsections (3) and (4) of new section 863D detail when the question of whether condition C is met is to be determined or re-determined.
20. Subsection (5) of new section 863D provides that where condition C is determined to be met, or not met, at the relevant time, it is treated as met, or not met, until the question is re-determined either, at the start of the next tax year, or because there is a change in M's contribution to the LLP or another change of circumstances which might affect the question as to whether condition C is met.
21. Subsections (6) and (7) of new section 863D provide that an increase in M's contribution which would result in condition C not being met is not to have that effect unless it is reasonable to expect that condition C will not be met for the remainder of the tax year in which the increase falls.
22. Subsections (8) to (11) of new section 863D provide for the amount of the contribution to be treated as reduced in certain circumstances.
23. New section 863E explains what is meant by the term "M's contribution to the LLP" and how the basic calculation is to be made. The legislation labels M's contribution to the LLP as "amount A".
24. Subsection (1) of new section 863F details the circumstances in which a deemed contribution is to be taken into account as a contribution to the LLP under subsection (2) of new section 863F. These circumstances are where an existing member at 6 April 2014 gives an undertaking by 6 April 2014 to make a contribution to the capital of the LLP by 5 July 2014, or a new member gives an undertaking, by the date they became a member, to make a contribution by 5 July 2014, or within 2 months of the date of their becoming a member, if later, and the contribution, when made, would be a contribution included in amount A in new section 863E. An undertaking does not have to be legally enforceable.
25. Subsection (2) of new section 863F provides the consequences of new section 863F being met. In determining if condition C is met M is treated as having made the contribution on 6 April 2014, or the date on which M became a member, as appropriate. M is also treated as having made the contribution if there is a re-determination in the 3 month period to 5 July 2014, or the 2 month period from M becoming a member, to the extent that M has not actually made the contribution.
26. Subsection (3) of new section 863F provides that a re-determination of condition C is not triggered when M makes the actual contribution, in whole or in part, in the 3 month period to 5 July 2014, or the 2 month period from M becoming a member, as appropriate.
27. Subsections (4) and (5) of new section 863F provide the consequences of M failing to meet the undertaking to make the contribution, either in whole or in part. If M fails to make all, or part, of the contribution then the determination of whether condition C was met on 6 April 2014, or the date on which M became a member, is revisited without taking into account the deemed contribution or the part not paid. If the re-calculation shows that

condition C would have been met it is treated as being met on the 6 April 2014, or the date on which M became a member, as appropriate.

28. The following examples illustrate how the deemed contributions rules work.

29. Example 2: M is an existing member of an LLP at 6 April 2014 who has not previously contributed capital to the LLP. On 5 April 2014 M gives an undertaking to the LLP that he will make a contribution of £50,000 by 5 July 2014. The contribution when made would constitute amount A in new section 863E. The question whether condition C is met is determined on 6 April 2014 and takes into account the deemed contribution of £50,000 resulting in condition C not being met. On 30 June 2014 M contributes £50,000 to the LLP. This contribution does not trigger a re-determination and condition C is treated as not met until the end of the 2014-15 tax year or unless there is a later change that requires a re-determination.

30. Example 3: M is an existing member of an LLP at 6 April 2014 who has not previously contributed capital to the LLP. On 5 April 2014 M gives an undertaking to the LLP that he will make a contribution of £50,000 on 5 July 2014. The contribution when made would constitute amount A in new section 863E. The question whether condition C is met is determined on 6 April 2014 and takes into account the deemed contribution of £50,000 resulting in condition C not being met. M fails to make any of the contribution by 5 July 2014. On 6 July 2014 the question whether condition C was met at 6 April 2014 is revisited. M is not treated as having made a contribution so condition C is met. M also met conditions A and B on 6 April 2014 so is treated as a salaried member from that date.

31. New section 863G contains anti-avoidance rules.

32. Subsection (1) of new section 863G provides that no regard is to be had to any arrangements with a main purpose of securing that new section 863A(2) of ITTOIA 2005 does not apply to an individual member of the LLP.

33. Subsections (2) and (3) of new section 863G detail the circumstances in which the consequences in subsection (4) apply. These are where an individual (“X”), who is not a member of the LLP, performs services under arrangements involving a non-individual member of the LLP (“Y”), a main purpose of the arrangements is to secure that new section 863A(2) of ITTOIA 2005 does not apply to that individual, alone or with other individuals, and an amount arises to Y relating to X’s services which would have been employment income of X if X was treated as employed by the LLP.

34. Subsection (4) of new section 863G provides the consequences if the circumstances in subsections (2) and (3) arise. X is treated as a member of the LLP in whose case section 863A(2) of ITTOIA 2005 applies and the amount arising to Y relating to X’s services is treated as employment income of X. It also ensures that the amount treated as employment income of X is not to be treated as income of X again for income tax purposes under another charging provision.

35. Subsection (5) of new section 863G prevents new section 863A(2) of ITTOIA 2005 from applying in the case of a member if it would apply because of arrangements with a main purpose of securing that new section 850C of ITTOIA 2005 (excess profit allocation to non-individual partners) does not apply in relation to that member, alone or with others.
36. Subsection (6) of new section 863G defines “arrangements” for the purposes of new section 863G.
37. Paragraph 2 inserts new section 1273A into Part 17 of the Corporation Tax Act 2009 (CTA 2009).
38. New section 1273A applies at any time when new section 863A(2) of ITTOIA 2005 applies and makes corresponding provision for corporation tax purposes.
39. Paragraph 3(2) inserts new section 94AA into Chapter 5 of Part 2 of ITTOIA 2005.
40. Subsections (1) to (3) of new section 94AA apply where a member (“M”) of an LLP is treated as being employed under new section 863A(2) of ITTOIA 2005 and provide for a deduction for expenses paid by the LLP in respect of M’s employment under new section 863A(2) if no deduction would otherwise be allowed for the payment. The availability of this deduction is subject to the existing prohibitions applying to Part 2 of ITTOIA 2005 and those listed in subsection (3).
41. Paragraph 3(3) applies new section 94AA of ITTOIA 2005 to property businesses.
42. Paragraph 4(2) inserts new section 92A into Chapter 5 of Part 3 of CTA 2009.
43. Subsections (1) to (3) of new section 92A apply where new section 1273A(2) of CTA 2009 applies in the case of a member (“M”) of the LLP and provide for a deduction for expenses paid by the LLP in respect of M’s employment under new section 1273A(2) if no deduction would otherwise be allowed for the payment. The availability of this deduction is subject to the existing prohibitions applying to Part 3 of CTA 2009 and those listed in subsection (3).
44. Paragraph 4(3) applies new section 92A of CTA 2009 to property businesses.
45. Paragraph 4(4) amends Chapter 2 of Part 16 of CTA 2009 and inserts new section 1227A.
46. Subsections (1) and (2) of new section 1227A detail the circumstances in which the section applies and the consequences of it applying. This section provides a deduction for management expenses purposes where a company with investment business is a member of an LLP, expenses of management of the company’s investment business are paid in respect of the employment of a member of the LLP to whom new section 1273A(2) of CTA 2009 applies and the expenses paid would not otherwise be referable to any accounting period. The availability of a deduction is subject to the existing prohibitions that apply to deductions for management expenses.

47. Paragraph 5 makes supplementary provision in Chapter 8 of Part 2 of Income Tax (Earnings and Pensions) Act 2003.
48. Paragraph 6 provides for commencement.

BACKGROUND NOTE

49. This change is part of a wider review of certain parts of the partnership rules announced in Budget 2013. A consultation document, *Partnerships: A review of two aspects of the tax rules*, was published on the gov.uk website on 20 May 2013 and the consultation closed on 9 August 2013.
50. This element of the partnerships review measure is discussed in the consultation document under the heading: *Disguised Employment*.
51. Detailed guidance on the legislation (*Salaried Member Rules: revised technical note and guidance*) was published on 21 February 2014 on the gov.uk website.
52. If you have any questions about this change, or comments on the legislation, please contact James Ewington on 03000 553788 (email: partnership.review@hmrc.gsi.gov.uk).