HM Revenue & Customs

# Partnerships review: limited liability partnerships: treatment of salaried members

### Who is likely to be affected?

Individual members of a limited liability partnership (LLP) who work for the LLP on terms that are tantamount to employment ('salaried members') and LLPs that have salaried members.

### General description of the measure

This change will ensure that a salaried member of an LLP is treated as an employee of the LLP for income and corporation tax purposes. Associated changes to the National Insurance contributions (NICs) legislation are included in the NICs Bill 2013 and in new regulations to be laid and made under that Bill.

### Policy objective

This change makes the tax system fairer by ensuring that employment taxes are paid by LLP members who are essentially employees and the LLP as employer.

### Background to the measure

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.

## Detailed proposal

### Operative date

The change will have effect from 6 April 2014.

### Current law

Under section 863 of Income Tax (Trading and Other Income) Act 2005 and section 1273 of Corporation Tax Act 2009, if an LLP carries on a trade, profession or business with a view to profit its members are treated as partners.

### Proposed revisions

Legislation will be introduced in Finance Bill 2014 to change the treatment of a salaried member of an LLP from that of a partner to that of an employee for both income and corporation tax purposes.

The new rules will apply at any time when an individual (M) is a member of an LLP and three conditions are met:

Condition A is that there are arrangements in place under which M is to perform services for the LLP, in M's capacity as a member, and it would be reasonable to expect that the amounts payable by the LLP in respect of M's performance of those services will be wholly, or substantially wholly, fixed, or if variable, variable without reference to, or in practice unaffected by, the overall profits or losses of the LLP ('disguised salary').

Condition B is that the mutual rights and duties of the members and the LLP and its members do not give M significant influence over the affairs of the LLP.

Condition C is that M’s contribution to the LLP is less than 25 per cent of the disguised salary which it is reasonable to expect will be payable by the LLP in a relevant tax year in respect of M’s performance of services for the LLP.

In determining whether the salaried member rules apply any arrangements with a main purpose of circumventing the rules will be disregarded.

The salaried member rules will apply to an individual who is not a member of an LLP if the individual performs services for the LLP under arrangements involving a non-individual member of the LLP and those arrangements have a main purpose of securing that the salaried member rules do not apply to the individual.

The salaried members rules will not, however, apply to an individual, where they would otherwise apply, as a consequence of arrangements with a main purpose of ensuring that the new profit allocation rules do not apply (see Tax Information and Impact Note *Partnerships review: partnerships with mixed membership* published on 5 December 2013).

The legislation will also provide for a deduction for certain expenditure in respect of a salaried member’s employment that would not otherwise be deductible, subject to certain provisions that provide for disallowance on normal principles.

## Summary of impacts for the review

The following table is a summary of impacts for the partnerships review announced in Budget 2013 of which the change described above is a part.

<table>
<tr><td rowspan="6">Exchequer impact (£m)</td><td></td><td>2013-14</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td></tr>
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<tr><td>Economic impact</td><td colspan="7">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.</td></tr>
<tr><td>Impact on individuals and households</td><td colspan="7">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 Pay As You Earn rather than having to fill in a self assessment return. Overall the impact is expected on individuals and households to be negligible.</td></tr>
<tr><td>Equalities impact</td><td colspan="7">No impact is expected on any protected equality groups.</td></tr>
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| **Impact on businesses including civil society organisations** | This measure will have a negligible impact on businesses and civil society organisations.<br><br>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.<br><br>There would be some one off costs as professions and taxpayers need to understand the new rules and communicate them to their partnership members.<br><br>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. |
| **Operational impact (£m) (HMRC or other)** | The AIFM process requires changes to HM Revenue & Customs' (HMRC) systems and they are estimated to cost up to £1.6 million. There will also be some extra administrative costs to be borne by HMRC, currently estimated at £260,000 per annum.<br><br>There would also be some additional operational costs associated with the monitoring and checking records of notional and actual partners of partnerships but these are expected to be minimal.<br><br>For the relatively few public sector organisations using the partnership model, there would be administrative costs to understand the new rules. |
| **Other impacts** | Other impacts have been considered and none have 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).

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# Partnerships review: partnerships with mixed membership

### Who is likely to be affected?

This change will affect partnerships, including limited liability partnerships, where the partners or members include both individuals and non-individuals (mixed membership partnerships). Most commonly the non-individuals will be company members of the partnership.

### General description of the measure

The first element of this change will affect mixed membership partnerships where partnership profits are allocated to a non-individual partner in circumstances where an individual member may benefit from those profits. The second element will affect cases where partnership losses are allocated to an individual partner, instead of a non-individual partner, to enable the individual to access certain loss reliefs.

### Policy objective

This change makes the tax system fairer by preventing tax-motivated allocations of business profits and losses in mixed membership partnerships, including limited liability partnerships.

### Background to the measure

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.

## Detailed proposal

### Operative date

The changes will take effect from 6 April 2014 with the exception of anti-avoidance rules concerning tax-motivated profit allocations. These rules come into force on 5 December 2013 in order to protect against risks to tax revenue.

### Current law

The rules governing the allocation of a firm's profits and losses between partners for income tax and corporation tax purposes are in Part 9 of the Income Tax (Trading and Other income) Act 2005 (ITTOIA 2005) and Part 17 of the Corporation Tax Act 2009 (CTA 2009).

The general rule in section 849 of ITTOIA 2005 and section 1262 of CTA 2009 is that for any period of account a partner's share of a profit or loss of a firm is determined in accordance with the firm's profit-sharing arrangements during that period. This rule is subject to sections 850A and 850B of ITTOIA 2005, for income tax, and sections 1263 and 1264 of CTA 2009, for corporation tax, which revise the allocation where the firm is profit-making for the period but some partners have losses or the firm is loss-making but some of the partners have profits.

## Proposed revisions

Legislation will be introduced in Finance Bill 2014 in relation to mixed membership partnerships to reallocate excess profits allocated to a non-individual partner to an individual partner where the following conditions are met:

- a non-individual partner has a share of the firm's profit;
- the non-individual's share is excessive;
- an individual partner has the power to enjoy the non-individual's share or there are deferred profit arrangements in place; and
- it is reasonable to suppose that the whole or part of the non-individual's share is attributable to that power or arrangements.

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

The legislation will also include consequential provisions to prevent double taxation.

Legislation will also be introduced in Finance Bill 2014 to deny certain income tax loss reliefs and capital gains relief for a loss allocated to an individual partner where the individual is party to arrangements, the main purpose of which, or one of the main purposes of which, is to secure that some or all of the loss is allocated, or otherwise arises, to the individual, instead of a non-individual, with a view to the individual obtaining relief.

## Summary of impacts for the review

The following table is a summary of impacts for the partnerships review announced in Budget 2013 of which the change described above is a part.

<table>
<tr><td rowspan="5">Exchequer impact (£m)</td><td></td><td>2013-14</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td></tr>
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|---|---|
| **Impact on individuals and households** | Those individuals who are affected members of partnerships will now be required to pay the correct amount of tax and National Insurance contributions (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. |
| **Equalities impact** | No impact is expected on any protected equality groups. |
| **Impact on businesses including civil society organisations** | This measure will have a negligible impact on businesses and civil society organisations.<br><br>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.<br><br>There would be some one off costs as professions and taxpayers need to understand the new rules and communicate them to their partnership members.<br><br>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. |
| **Operational impact (£m) (HMRC or other)** | The AIFM process requires changes to HM Revenue & Customs' (HMRC) systems and they are estimated to cost up to £1.6 million. There will also be some extra administrative costs to be borne by HMRC, currently estimated at £260,000 per annum.<br><br>There would also be some additional operational costs associated with the monitoring and checking records of notional and actual partners of partnerships but these are expected to be minimal.<br><br>For the relatively few public sector organisations using the partnership model, there would be administrative costs to understand the new rules. |
| **Other impacts** | Other impacts have been considered and none have 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).

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# Partnerships review: alternative investment fund managers: deferred remuneration etc.

### Who is likely to be affected?

This change will affect the income tax treatment of members of partnerships and limited liability partnerships (LLPs) that manage alternative investment funds including where they are delegated to do so (AIFM partnerships).

### General description of the measure

The legislation will introduce a mechanism for members of AIFM partnerships to allocate certain 'restricted' profits to the partnership. These are profits that those members cannot immediately access because of requirements under the Alternative Investment Fund Managers Directive (AIFMD) (2011/61/EU) to defer remuneration of 'key staff'.

The legislation will impose a charge to tax on these businesses at the additional rate of tax (45 per cent) to be paid by the AIFM partnership.

### Policy objective

The primary objective of this change is to address the tax issue arising from restricted access to profits. The new mechanism will provide affected members of AIFM partnerships with a fair solution without recourse to arrangements involving tax-motivated allocations of business profits, which will be prevented as part of the Government's partnerships review (see details in the Tax Information and Impact Note on *Partnerships with mixed membership*).

### Background to the measure

This measure is part of a wider review of certain parts of the partnership rules announced at 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.

This element of the partnerships review measure is flagged up in the consultation document under the heading: *Partnership with mixed memberships – profits: Profit deferral and working capital arrangements.* Further information was received during the consultation period on the AIFMD issue and the use of mixed membership structures by AIFM partnerships. This was fed into the design of the new mechanism and a recosting exercise.

## Detailed proposal

### Operative date

The legislation will have effect on and after 6 April 2014.

### Current law

Individual members of partnerships (including LLPs) are charged to tax on their trading profits as they arise under Chapter 2 of Part 2 of Income Tax (Trading and Other Income) Act 2005. These profits are also subject to Class 4 National Insurance contributions (NICs) in accordance with section 15 of Social Security Contributions and Benefits Act 1992. This note only deals with the tax change while the NICs Bill 2013 deals with any associated NICs changes.

## Proposed revisions

Legislation will be introduced in Finance Bill 2014 to provide as follows:

- it will allow any partner in an AIFM partnership to allocate all or part of their 'relevant restricted profit' to the firm. Relevant restricted profit is deferred remuneration (within the meaning of the AIFMD) together with any remuneration which is awarded in the form of instruments that must be retained for at a period of at least 6 months;
- it will charge tax at the additional rate of income tax (currently, 45 per cent) on that income, with no reliefs or allowances to be available to set against it;
- where the relevant restricted profit ultimately vests with the partner who initially allocated it to the partnership, this is treated as taxable income of the partner in the relevant tax year. Credit will be available for the tax initially paid by the partnership on the profit, and any overpayment of tax may be repaid; and
- for capital gains tax purposes, the partner is treated as receiving any securities at a base cost equivalent to the amount of remuneration they represent, net of tax. The same amount is treated as the disposal consideration.

If the deferred remuneration does not vest in the partner who originally allocated the amount to the firm, the payment will be treated like any other partnership distribution. There will be no further tax liability and no entitlement to recover the tax paid on that element of the deferred remuneration. A power is provided to make regulations if required.

## Summary of impacts for the review

The following table is a summary of impacts for the partnership review announced in Budget 2013 of which the change described above is a part.

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<tr><td rowspan="5">Exchequer impact (£m)</td><td></td><td>2013-14</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td></tr>
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| **Impact on individuals and households** | 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 Pay As You Earn rather than having to fill in a self assessment return. Overall the impact is expected on individuals and households to be negligible. |
| **Equalities impact** | No impact is expected on any protected equality groups. |
| **Impact on businesses including civil society organisations** | This measure will have a negligible impact on businesses and civil society organisations.<br><br>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.<br><br>There would be some one off costs as professions and taxpayers need to understand the new rules and communicate them to their partnership members.<br><br>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. |
| **Operational impact (£m) (HMRC or other)** | The AIFM process requires changes to HM Revenue & Customs' (HMRC) systems and they are estimated to cost up to £1.6 million. There will also be some extra administrative costs to be borne by HMRC, currently estimated at £260,000 per annum.<br><br>There would also be some additional operational costs associated with the monitoring and checking records of notional and actual partners of partnerships but these are expected to be minimal.<br><br>For the relatively few public sector organisations using the partnership model, there would be administrative costs to understand the new rules. |
| **Other impacts** | Other impacts have been considered and none have 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).

HM Revenue & Customs

# Partnerships review: disposals of assets through partnerships

### Who is likely to be affected?

This change will affect those who use partnerships, including limited liability partnerships, to dispose of income streams or assets without triggering a charge to tax on income.

### General description of the measure

The legislation will apply where a person disposes of all or part of an asset or income stream by or though a partnership if the main purpose, or one of the main purposes, of the disposal, or any of the steps by which the disposal is effected, is to secure a tax advantage in relation to the charge to income tax or the charge to corporation tax on income.

The legislation will impose a charge to tax on income on the person making the disposal.

### Policy objective

This change makes the tax system fairer by preventing tax-motivated disposals of income streams or assets through partnerships giving rise to tax advantages.

### Background to the measure

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.

This element of the partnerships review measure is discussed in the consultation document under the heading: *Partnership members with differing tax attributes.*

## Detailed proposal

### Operative date

The legislation will have effect in relation to arrangements entered into on and after 6 April 2014 for income tax payers and 1 April 2014 for persons within the charge to corporation tax.

### Current law

The arrangements covered by this change are similar to those dealt with by the legislation concerning transfers of income streams (Chapter 1 in Part 16 of Corporation Taxes Act 2010 and Chapter 5A of Part 13 Income Tax Act 2007). However, the transfer of income stream provisions currently apply to partnerships only in very limited circumstances.

## Proposed revisions

Legislation will be introduced in Finance Bill 2014. The legislation will apply if directly or indirectly in consequence of or otherwise in connection with an arrangement:

- there is a disposal of an asset (in whole or part) or a right to income by or through a partnership from a member of the partnership or a connected person (the transferor) to another member; and
- the main purpose, or one of the main purposes, of one or more steps taken in effecting the disposal is the obtaining of a tax advantage in relation to the charge to income tax or the charge to corporation tax on income.

'Disposal' takes the same meaning as in the Taxation of Chargeable Gains Act 1992 and includes both part disposal and in substance disposals such as may be effected by (for example) a change of partnership profit sharing ratios.

The legislation will not apply if the transferor and transferor are relatives.

Where the legislation applies the 'relevant amount' is to be charged to tax as if it were income of the transferor. The relevant amount is the consideration given for the asset or income stream, unless the consideration given is much less than the value of the asset in which case the charge to tax will be based on a deemed market value disposal.

## Summary of impacts for the review

The following table is a summary of impacts for the partnership review announced in Budget 2013 of which the change described above is a part.

<table>
<tr><td rowspan="5">Exchequer impact (£m)</td><td></td><td>2013-14</td><td>2014-15</td><td>2015-16</td><td>2016-17</td><td>2017-18</td><td>2018-19</td></tr>
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| **Equalities impact** | No impact is expected on any protected equality groups. |
| **Impact on businesses including civil society organisations** | This measure will have a negligible impact on businesses and civil society organisations.<br><br>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.<br><br>There would be some one off costs as professions and taxpayers need to understand the new rules and communicate them to their partnership members.<br><br>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. |
| **Operational impact (£m) (HMRC or other)** | The AIFM process requires changes to HM Revenue & Customs' (HMRC) systems and these are estimated to cost up to £1.6 million. There will also be some extra administrative costs to be borne by HMRC, currently estimated at £260,000 per annum.<br><br>There would also be some additional operational costs associated with the monitoring and checking records of notional and actual partners of partnerships but these are expected to be minimal.<br><br>For the relatively few public sector organisations using the partnership model, there would be administrative costs to understand the new rules. |
| **Other impacts** | Other impacts have been considered and none have been identified. |

## Monitoring and evaluation

The partnership 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).

**1 Partnerships**

Schedule 1 makes provision in relation to partnerships.

# SCHEDULES

## SCHEDULE 1

Section 1

PARTNERSHIPS

PART 1

LIMITED LIABILITY PARTNERSHIPS: TREATMENT OF SALARIED MEMBERS

*Main provision*

1 In Part 9 of ITTOIA 2005 (partnerships) after section 863 (limited liability partnerships) insert—

**“863A Limited liability partnerships: salaried members**

(1) Subsection (2) applies at any time when conditions A to C in section 863B are met in the case of an individual (“M”) who is a member of a limited liability partnership in relation to which section 863(1) applies.

(2) For the purposes of the Income Tax Acts—

(a) M is to be treated as being employed by the limited liability partnership under a contract of service instead of being a member of the partnership, and

(b) accordingly, M’s rights and duties as a member of the limited liability partnership are to be treated as rights and duties under that contract of service.

(3) This section needs to be read with section 863C (anti-avoidance).

**863B Conditions A to C**

(1) Condition A is that there are arrangements in place as a result of which—

(a) at or after the time at which it is being determined whether the condition is met, M is to perform services for the limited liability partnership in M’s capacity as a member of the partnership, and

(b) it is reasonable to expect that the amounts payable by the limited liability partnership in respect of M’s performance of those services will be wholly, or substantially wholly, disguised salary.

(2) An amount is “disguised salary” if it—

(a) is fixed,

(b) if it is variable, is varied without reference to the overall amount of the profits or losses of the limited liability partnership, or

(c) is not, in practice, affected by the overall amount of those profits or losses.

(3) In subsection (1) "arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).

(4) Condition B is that the mutual rights and duties of the members of the limited liability partnership, and of the partnership and its members, do not give M significant influence over the affairs of the partnership.

(5) Condition C is that, at the time at which it is being determined whether the condition is met ("the relevant time"), M's contribution to the limited liability partnership is less than 25% of the amount given by subsection (6).

(6) That amount is the total amount of the disguised salary which, it is reasonable to expect, will be payable in the relevant tax year by the limited liability partnership in respect of M's performance of services for the partnership in M's capacity as a member of the partnership.

"The relevant tax year" means the tax year in which the relevant time falls.

(7) The question of whether condition C is met is to be determined—

(a) at the beginning of the tax year 2014-15 or, if later, the time at which M becomes a member of the limited liability partnership;

(b) after that, at the beginning of each tax year.

(8) If in a tax year—

(a) there is a change in M's contribution to the limited liability partnership, or

(b) there is otherwise a change of circumstances which might affect the question of whether condition C is met,

the question of whether the condition is met is to be re-determined at the time of the change.

(9) If the change is an increase in M's contribution to the limited liability partnership and condition C would not otherwise be met at the time of the change, condition C is to be treated as met unless it is reasonable to expect that at no subsequent time in the tax year will condition C be met.

(10) If it is determined that condition C is met at any time mentioned in subsection (7)(a) or (b) or (8), the condition is to be treated as met at all subsequent times until the question is required to be re-determined by virtue of subsection (7)(b) or (8).

(11) For the purposes of subsection (5) M's contribution to the limited liability partnership is amount A determined under section 108 of ITA 2007 (meaning of "contribution to the LLP") as at the relevant time (subject to subsection (13)).

(12) That section is to be applied with the omission of—
- (a) subsections (5)(b) and (9), and
- (b) in subsection (6) the words from "but" to the end.

(13) If there are any excluded days in the relevant tax year (see subsections (14) and (15)), amount A is to be reduced by multiplying it by the following fraction—

$$\frac{365 - E}{365}$$

where E is the number of excluded days in the relevant tax year.

(14) If, at the relevant time, it is reasonable to expect that M will not be a member of the limited liability partnership for the whole of the rest of the relevant tax year, any day in the relevant tax year—
- (a) which falls after the day on which the relevant time falls, and
- (b) on which it is reasonable to expect that M will not be a member of the limited liability partnership,

is an "excluded" day for the purposes of subsection (13).

(15) If the relevant time is—
- (a) the time at which M becomes a member of the limited liability partnership, or
- (b) the time of an increase in M's contribution to the limited liability partnership,

any day in the relevant tax year which falls before the day on which the relevant time falls is an "excluded" day for the purposes of subsection (13).

**863C Anti-avoidance**

(1) In determining whether section 863A(2) applies in the case of an individual who is a member of a limited liability partnership, no regard is to be had to any arrangements the main purpose, or one of the main purposes, of which is to secure that section 863A(2) does not apply in the case of—
- (a) the individual, or
- (b) the individual and one or more other individuals.

(2) Subsection (4) applies if—
- (a) an individual ("X") personally performs services for a limited liability partnership at a time when X is not a member of the partnership,
- (b) X performs the services under arrangements involving a member of the limited liability partnership ("Y") who is not an individual,
- (c) the main purpose, or one of the main purposes, of those arrangements is to secure that section 863A(2) does not apply in the case of X or in the case of X and one or more other individuals, and
- (d) in relation to X's performance of the services, an amount falling within subsection (3) arises to Y in respect of Y's membership of the limited liability partnership.

(3) An amount falls within this subsection if—

(a) were X performing the services under a contract of service by which X were employed by the limited liability partnership, and

(b) were the amount to arise to X directly from the limited liability partnership,

the amount would be employment income of X in respect of the employment.

(4) If this subsection applies, in relation to X's performance of the services, X is to be treated on the following basis—

(a) X is a member of the limited liability partnership in whose case section 863A(2) applies,

(b) the amount arising to Y arises instead to X directly from the limited liability partnership, and

(c) that amount is employment income of X in respect of the employment under section 863A(2) accordingly.

(5) Section 863A(2) does not apply in the case of a member of a limited liability partnership if, apart from this subsection, it would apply in consequence of arrangements the main purpose, or one of the main purposes, of which is to secure that section 850C does not apply for one or more periods of account in relation to—

(a) the member, or

(b) the member and one or more other members of the limited liability partnership.

(6) In this section "arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)."

2 In Part 17 of CTA 2009 (partnerships) after section 1273 (limited liability partnerships) insert—

**"1273A Limited liability partnerships: salaried members**

(1) Subsection (2) applies at any time when section 863A(2) of ITTOIA 2005 (limited liability partnerships: salaried members) applies in the case of an individual ("M") who is a member of a limited liability partnership in relation to which section 1273(1) applies.

(2) In relation to the charge to corporation tax on income, for the purposes of the Corporation Tax Acts—

(a) M is to be treated as being employed by the limited liability partnership under a contract of service instead of being a member of the partnership, and

(b) accordingly, M's rights and duties as a member of the limited liability partnership are to be treated as rights and duties under that contract of service."

*Supplementary provision: deductions*

3 (1) ITTOIA 2005 is amended as follows.

(2) At the end of Chapter 5 of Part 2 (trade profits: rules allowing deductions) insert—

*"Limited liability partnerships: salaried members*

**94AA Deductions in relation to salaried members**

(1) This section applies in relation to a limited liability partnership if section 863A(2) (limited liability partnerships: salaried members) applies in the case of a member of the partnership ("M").

(2) In calculating for a period of account under section 849 (calculation of firm's profits and losses) the profits of a trade carried on by the limited liability partnership, a deduction is allowed for expenses paid by the partnership in respect of M's employment under section 863A(2) if no deduction would otherwise be allowed for the payment.

(3) This section is subject to section 33 (capital expenditure), section 34 (expenses not wholly and exclusively for trade etc), section 45 (business entertainment and gifts) and section 53 (social security contributions)."

(3) In Chapter 3 of Part 3 (profits of property businesses: basic rules), in the table in section 272(2) (application of trading income rules), after the entry for section 94A insert—

| | |
|---|---|
| "section 94AA | deductions in relation to salaried members of limited liability partnerships". |

4 (1) CTA 2009 is amended as follows.

(2) At the end of Chapter 5 of Part 3 (trade profits: rules allowing deductions) insert—

*"Limited liability partnerships: salaried members*

**92A Deductions in relation to salaried members**

(1) This section applies in relation to a limited liability partnership if section 1273A(2) (limited liability partnerships: salaried members) applies in the case of a member of the partnership ("M").

(2) In calculating for a period of account under section 1259 (calculation of firm's profits and losses) the profits of a trade carried on by the limited liability partnership, a deduction is allowed for expenses paid by the partnership in respect of M's employment under section 1273A(2) if no deduction would otherwise be allowed for the payment.

(3) This section is subject to—
(a) section 53 (capital expenditure),
(b) section 54 (expenses not wholly and exclusively for trade etc),
(c) section 1298 (business entertainment and gifts), and
(d) section 1302 (social security contributions)."

(3) In Chapter 3 of Part 4 (profits of property businesses: basic rules), in the table in section 210(2) (application of trading income rules), after the entry for section 92 insert—

| | |
|---|---|
| "section 92A | deductions in relation to salaried members of limited liability partnerships". |

(4) In Chapter 2 of Part 16 (companies with investment business: management expenses)—

(a) in section 1224(1) (accounting period to which expenses are referable) for "1227" substitute "1227A", and

(b) after section 1227 insert—

**"1227A Management expenses in relation to salaried members of limited liability partnerships**

(1) This section applies in relation to a company if—

(a) as a member of a limited liability partnership, the company is a company with investment business,

(b) section 1273A(2) (limited liability partnerships: salaried members) applies in the case of a member of the partnership ("M"), and

(c) expenses of management of the company's investment business are paid in respect of M's employment under section 1273A(2) but are not referable to any accounting period under sections 1225 to 1227.

(2) The expenses are to be treated as referable to the accounting period in which they are paid."

*Commencement*

5 The amendments made by this Part are treated as having come into force on 6 April 2014.

## PART 2

## PARTNERSHIPS WITH MIXED MEMBERSHIP

*Main provision*

6 (1) Part 9 of ITTOIA 2005 (partnerships) is amended as follows.

(2) In section 850 (allocation of firm's profits and losses between partners) in subsection (1) for "and 850B" substitute "to 850D".

(3) After section 850B insert—

**"850C Excess profit allocation to non-individual partners**

(1) Subsections (4) and (5) apply if—

(a) for a period of account ("the relevant period of account")—

(i) the calculation under section 849 in relation to an individual partner ("A") (see subsection (6)) produces a profit for the firm, and

(ii) A's share of that profit determined under section 850 or 850A ("A's profit share") is a profit or is neither a profit nor a loss,

(b) a non-individual partner ("B") (see subsection (6)) has a share of the profit for the firm mentioned in paragraph (a)(i) ("B's profit share") which is a profit (see subsection (7)), and

(c) condition X or Y is met.

(2) Condition X is that it is reasonable to suppose that—

(a) amounts representing A's deferred profit (see subsection (8)) are included in B's profit share, and

(b) in consequence, both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would otherwise have been.

(3) Condition Y is that—

(a) B's profit share exceeds the appropriate notional profit (see subsections (10) to (17)),

(b) A has the power to enjoy B's profit share ("A's power to enjoy") (see subsections (18) to (20)), and

(c) it is reasonable to suppose that—

(i) the whole or any part of B's profit share is attributable to A's power to enjoy, and

(ii) both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would have been in the absence of A's power to enjoy.

(4) A's profit share is increased by so much of the amount of B's profit share as, it is reasonable to suppose, is attributable to—

(a) A's deferred profit, or

(b) A's power to enjoy,

as determined on a just and reasonable basis.

But any increase by virtue of paragraph (b) is not to exceed the amount of the excess mentioned in subsection (3)(a) after deducting from that amount any increase by virtue of paragraph (a).

(5) If B is chargeable to income tax, in applying sections 850 to 850B in relation to B for the relevant period of account, such adjustments are to be made as are just and reasonable to take account of the increase in A's profit share under subsection (4).

(This subsection does not apply for the purposes of subsection (7) or section 850D(7).)

(6) A partner in a firm is an "individual partner" if the partner is an individual and "non-individual partner" is to be read accordingly; but "non-individual partner" does not include the firm itself where it is treated as a partner under section 863E.

(7) B's profit share is to be determined by applying section 850 and, if relevant, section 850A in relation to B for the relevant period of account (whether or not B is chargeable to income tax) on the assumption that the calculation under section 849 in relation to B produces the profit for the firm mentioned in subsection (1)(a)(i).

(8) "A's deferred profit" is any remuneration or other benefits or returns the provision of which to A has been deferred (whether pending the meeting of any conditions (including conditions which may never be met) or otherwise).

(9) "The relevant tax amount" is the total amount of tax which, apart from this section, would be chargeable in respect of A and B's income as partners in the firm.

(10) "The appropriate notional profit" is the sum of the appropriate notional return on capital and the appropriate notional consideration for services.

(11) "The appropriate notional return on capital" is—
(a) the return which B would receive for the relevant period of account in respect of B's contribution to the firm were the return to be calculated on the basis mentioned in subsection (12), less
(b) any return actually received for the relevant period of account in respect of B's contribution to the firm which is not included in B's profit share.

(12) The return mentioned in subsection (11)(a) is to be calculated on the basis that it is a return which is—
(a) by reference to the time value of an amount of money equal to B's contribution to the firm, and
(b) at a rate which (in all the circumstances) is a commercial rate of interest.

(13) For the purposes of subsections (11) and (12) B's contribution to the firm is amount A determined under section 108 of ITA 2007 (meaning of "contribution to the LLP").

(14) That section is to be applied—
(a) reading references to the individual as references to B and references to the LLP as references to the firm, and
(b) with the omission of—
(i) subsections (5)(b) and (9), and
(ii) in subsection (6) the words from "but" to the end.

(15) "The appropriate notional consideration for services" is—
(a) the amount which B would receive in consideration for any services provided to the firm by B during the relevant period of account were the consideration to be calculated on the basis mentioned in subsection (16), less
(b) any amount actually received in consideration for any such services which is not included in B's profit share.

(16) The consideration mentioned in subsection (15)(a) is to be calculated on the basis that B is not a partner in the firm and is acting at arm's length from the firm.

(17) Any services, the provision of which involves any partner in the firm in addition to B, are to be ignored for the purposes of subsection (15).

(18) A has the power to enjoy B's profit share if—

(a) A is connected with B by virtue of a provision of section 993 of ITA 2007 (meaning of "connected" persons) other than subsection (4) of that section, or

(b) any of the enjoyment conditions is met in relation to B's profit share or any part of B's profit share.

(19) The enjoyment conditions are—

(a) B's profit share, or the part, is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of A, whether in the form of income or not;

(b) the receipt or accrual of B's profit share, or the part, by or to B operates to increase the value to A of any assets held by, or for the benefit of, A;

(c) A receives or is entitled to receive at any time any benefit provided or to be provided (directly or indirectly) out of B's profit share or the part;

(d) A may become entitled to the beneficial enjoyment of B's profit share, or the part, if one or more powers are exercised or successively exercised by any person;

(e) A is able in any manner to control (directly or indirectly) the application of B's profit share or the part.

(20) In subsection (19) references to A include any person connected with A apart from B.

(21) Subsection (22) applies if—

(a) the increase under subsection (4), or any part of it, is allocated by A to the firm itself under section 863E, and

(b) B makes a payment to the firm representing any income tax for which the firm is liable by virtue of section 863E in respect of the amount of the increase allocated to it.

(22) The payment is not to be taken into account in calculating any income of any person for income tax purposes.

**850D Excess profit allocation: cases involving individuals who are not partners**

(1) Subsections (4) and (5) apply if—

(a) at a time during a period of account ("the relevant period of account") in respect of a firm, an individual ("A") personally performs services for the firm,

(b) if A had been a partner in the firm throughout the relevant period of account, the calculation under section 849 in relation to A for the relevant period of account would have produced a profit for the firm,

(c) a non-individual partner ("B") in the firm (see subsection (6)) has a share of that profit ("B's profit share") which is a profit (see subsection (7)),

(d) it is reasonable to suppose that A would have been a partner in the firm at a time during the relevant period of account or any earlier period of account but for the provision contained in section 850C (see also subsections (8) to (10)), and

(e) condition X or Y is met.

(2) Condition X is that it is reasonable to suppose that amounts representing A's deferred profit (see subsection (11)) are included in B's profit share.

(3) Condition Y is that—

(a) B's profit share exceeds the appropriate notional profit (see subsection (12)),

(b) A has the power to enjoy B's profit share ("A's power to enjoy") (see subsection (13)), and

(c) it is reasonable to suppose that the whole or any part of B's profit share is attributable to A's power to enjoy.

(4) A is to be treated on the following basis—

(a) A is a partner in the firm throughout the relevant period of account (but not for the purposes of section 863E),

(b) A's share of the firm's profit for the relevant period of account is so much of the amount of B's profit share as, it is reasonable to suppose, is attributable to—

(i) A's deferred profit, or

(ii) A's power to enjoy,

as determined on a just and reasonable basis, and

(c) A's share of the firm's profit is chargeable to income tax under the applicable provisions of the Income Tax Acts for the tax year in which the relevant period of account ends.

But A's share of the firm's profit by virtue of paragraph (b)(ii) is not to exceed the amount of the excess mentioned in subsection (3)(a) after deducting from that amount A's share of the firm's profit (if any) by virtue of paragraph (b)(i).

(5) If B is chargeable to income tax, in applying sections 850 to 850B in relation to B for the relevant period of account, such adjustments are to be made as are just and reasonable to take account of A's share of the firm's profit under subsection (4).

(This subsection does not apply for the purposes of subsection (7) or section 850C(7).)

(6) "Non-individual partner" is to be read in accordance with section 850C(6).

(7) B's profit share is to be determined by applying section 850 and, if relevant, section 850A in relation to B for the relevant period of account (whether or not B is chargeable to income tax) on the assumption that the calculation under section 849 in relation to B produces the profit for the firm mentioned in subsection (1)(b).

(8) The requirement of subsection (1)(d) is to be assumed to be met if, at a time during the relevant period of account, A is a member of a partnership which is associated with the firm.

(9) A partnership is "associated" with the firm if—

(a) it is a member of the firm, or

(b) it is a member of a partnership which is associated with the firm (whether by virtue of paragraph (a) or this paragraph).

(10) In subsections (8) and (9) "partnership" includes a limited liability partnership whether or not section 863(1) applies in relation to it.

(11) "A's deferred profit" is to be read in accordance with section 850C(8).

(12) Section 850C(10) to (17) applies for the purpose of determining "the appropriate notional profit"; and A is to be treated as a partner in the firm for the purposes of section 850C(17).

(13) Section 850C(18) to (20) applies for the purpose of determining if A has the power to enjoy B's profit share.

**850E Payment from B to A**

(1) Subsection (2) applies in a case in which section 850C(4) or section 850D(4) applies if—

(a) A and B have an agreement in relation to B's profit share,

(b) as a result of the agreement, out of B's profit share B makes a payment (directly or indirectly) to A which does not exceed the amount of the increase under section 850C(4) or the amount of A's share of the firm's profit under section 850D(4), and

(c) the payment is not made under any arrangements the main purpose, or one of the main purposes, of which is the obtaining of a tax advantage for any person.

(2) The payment—

(a) is not to be taken into account in calculating any income of A or B for income tax purposes, and

(b) is not for any purpose of the Income Tax Acts to be regarded as a distribution.

(3) In subsection (1)—

"arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable),

"B's profit share" has the same meaning as in section 850C or 850D (as the case may be), and

"tax advantage" has the meaning given by section 1139 of CTA 2010."

7 (1) Chapter 3 of Part 4 of ITA 2007 (trade loss relief: restrictions for certain partners) is amended as follows.

(2) In section 102 (overview of Chapter) after subsection (2) insert—

"(2A) This Chapter also provides for no relief to be given for a loss made by an individual in a trade carried on by the individual as a partner in a firm in certain cases where some or all of the loss is allocated to the individual rather than a person who is not an individual (see section 116A)."

(3) At the end insert—

*"Partnerships with mixed membership etc*

**116A Excess loss allocation to partners who are individuals**

(1) Subsection (2) applies if—

(a) in a tax year, an individual ("A") makes a loss in a trade as a partner in a firm, and

(b) A's loss arises, wholly or partly—

(i) directly or indirectly in consequence of, or

(ii) otherwise in connection with,

relevant tax avoidance arrangements.

(2) No relevant loss relief may be given to A for A's loss.

(3) In subsection (1)(b) "relevant tax avoidance arrangements" means arrangements—

(a) to which A is party, and

(b) the main purpose, or one of the main purposes, of which is to secure that losses of a trade are allocated, or otherwise arise, in whole or in part to A, rather than a person who is not an individual, with a view to A obtaining relevant loss relief.

(4) In subsection (3)(b) references to A include references to A and other individuals.

(5) For the purposes of subsection (3)(b) it does not matter if the person who is not an individual is not a partner in the firm or is unknown or does not exist.

(6) In this section—

"arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and

"relevant loss relief" means—

(a) sideways relief,

(b) relief under section 83 (carry-forward trade loss relief),

(c) relief under section 89 (terminal trade loss relief), or

(d) capital gains relief.

(7) This section applies to professions as it applies to trades."

8 (1) Chapter 4 of Part 4 of ITA 2007 (losses from property businesses) is amended as follows.

(2) In section 117 (overview of Chapter) in subsection (3) for "and 127B" substitute "to 127C".

(3) After section 127B insert—

**"127C Excess loss allocation to partners who are individuals**

(1) Subsection (2) applies if—

(a) in a tax year, an individual ("A") makes a loss in a UK property business or an overseas property business as a partner in a firm, and

(b) A's loss arises, wholly or partly—

(i) directly or indirectly in consequence of, or

(ii) otherwise in connection with,

relevant tax avoidance arrangements.

(2) No relevant loss relief may be given to A for A's loss.

(3) In subsection (1)(b) "relevant tax avoidance arrangements" means arrangements—
   (a) to which A is party, and
   (b) the main purpose, or one of the main purposes, of which is to secure that losses of a UK property business or an overseas property business are allocated, or otherwise arise, in whole or in part to A, rather than a person who is not an individual, with a view to A obtaining relevant loss relief.

(4) In subsection (3)(b) references to A include references to A and other individuals.

(5) For the purposes of subsection (3)(b) it does not matter if the person who is not an individual is not a partner in the firm or is unknown or does not exist.

(6) In this section—
   "arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), and
   "relevant loss relief" means relief under section 118 (carry-forward property loss relief) or section 120 (property loss relief against general income)."

9 (1) Part 17 of CTA 2009 (partnerships) is amended as follows.

(2) In section 1262 (allocation of firm's profits and losses between partners) in subsection (1) for "and 1264" substitute "to 1264A".

(3) After section 1264 insert—

**"1264A Excess profit allocation to non-individual partners etc**

(1) Subsection (2) applies in a case in which—
   (a) section 850C(4) or 850D(4) of ITTOIA 2005 applies for a period of account ("the relevant period of account"), and
   (b) the partner who is "B" for the purposes of section 850C or 850D of that Act (as the case may be) is a company.

(2) In applying sections 1262 to 1264 in relation to the company—
   (a) for the accounting period of the firm which coincides with the relevant period of account, or
   (b) if no accounting period of the firm coincides with the relevant period of account, for accounting periods of the firm in which the relevant period of account falls,

such adjustments are to be made as are just and reasonable to take account of the increase under section 850C(4) of ITTOIA 2005 or A's share of the firm's profit under section 850D(4) of that Act.

(3) If relevant, sections 850C(21) and (22) and 850E of ITTOIA 2005 apply for corporation tax purposes as they apply for income tax purposes."

*Commencement*

10 The amendments made by paragraphs 6 and 9 are treated as having come into force on 5 December 2013 and have effect in accordance with paragraphs 11 and 12.

11 (1) Section 850C of ITTOIA 2005 has effect for periods of account beginning on or after 6 April 2014 (and section 850E of ITTOIA 2005 and section 1264A of CTA 2009 have effect accordingly).

(2) Sub-paragraphs (3) and (4) apply in relation to a firm where a period of account ("the straddling period") begins before 6 April 2014 but ends on or after that date.

(3) Assume that the part of the straddling period falling on or after 6 April 2014 is a separate period of account.

(4) If section 850C(4) of ITTOIA 2005 would apply in relation to one or more partners in the firm for the assumed separate period of account, Part 9 of that Act has effect as if that part of the straddling period were a separate period of account.

12 (1) Section 850D of ITTOIA 2005 has effect for periods of account beginning on or after 6 April 2014 (and section 850E of ITTOIA 2005 and section 1264A of CTA 2009 have effect accordingly).

(2) Sub-paragraphs (3) and (4) apply in relation to a firm where a period of account ("the straddling period") begins before 6 April 2014 but ends on or after that date.

(3) Assume that the part of the straddling period falling on or after 6 April 2014 is a separate period of account.

(4) If section 850D(4) of ITTOIA 2005 would apply in relation to one or more individuals for the assumed separate period of account, Part 9 of that Act has effect as if that part of the straddling period were a separate period of account.

13 (1) The amendments made by paragraphs 7 and 8 have effect in relation to losses made in the tax year 2014-15 and subsequent tax years.

(2) Sub-paragraphs (3) and (4) apply for the purposes of section 116A or 127C of ITA 2007 if a loss made by an individual as a partner in a firm arises in a period of account ("the straddling period") which begins before 6 April 2014 but ends on or after that date.

(3) The loss is to be apportioned between the part of the straddling period falling before 6 April 2014 and the part falling on or after that date—
   (a) on a time basis according to the respective lengths of those parts of the straddling period, or
   (b) if that method produces a result that is unjust or unreasonable, on a just and reasonable basis.

(4) Section 116A or 127C of ITA 2007 does not apply in relation to the loss so far as it is apportioned to the part of the straddling period falling before 6 April 2014.

## PART 3

## ALTERNATIVE INVESTMENT FUND MANAGERS: DEFERRED REMUNERATION ETC

*Main provision*

14 At the end of Part 9 of ITTOIA 2005 (partnerships) insert—

*"Alternative investment fund managers*

**"863D Election for special provision for alternative investment fund managers to apply**

(1) Section 863E applies in relation to an AIFM trade of an AIFM firm if the AIFM firm elects for that section to apply.

(2) An election under this section must be made within 6 months after the end of the first period of account for which the election is to have effect.

(3) An "AIFM firm" is a firm carrying on a trade which involves—

(a) wholly or mainly, managing one or more AIFs, or

(b) wholly or partly, carrying out one or more functions of a person who is managing one or more AIFs—

(i) as that person's delegate, or

(ii) as the sub-delegate of a delegate of that person,

and such a trade is called an "AIFM trade".

(4) In subsection (3) references to managing one or more AIFs are to be read in accordance with regulation 4(2) of the Alternative Investment Fund Managers Regulations 2013 (S.I. 2013/1773).

**863E Allocation of profit to the AIFM firm**

(1) This section applies for a period of account of the AIFM trade if—

(a) the calculation under section 849 in relation to a partner ("P") in the AIFM firm produces a profit, and

(b) P's share of that profit determined under section 850, 850A or 850C would, apart from this section, be a profit consisting (wholly or partly) of relevant restricted profit (see subsections (6) to (9)) chargeable to income tax under Chapter 2 of Part 2.

(2) P may allocate all or a part of the relevant restricted profit ("the allocated profit") to the AIFM firm itself.

(3) If P does so—

(a) the allocated profit is to be excluded from P's share of the AIFM firm's profit mentioned in subsection (1)(b),

(b) the AIFM firm is to be treated in accordance with subsection (4) as if it were itself a person who is a partner in the AIFM firm (and for this purpose, in the case of a limited liability partnership, it is the body corporate which is to be treated as that person), and

(c) all enactments applying generally to income tax are to apply accordingly with any necessary modifications (subject to subsection (5)).

(4) The AIFM firm is treated on the following basis—

(a) the calculation under section 849 in relation to the AIFM firm for the period of account produces the profit mentioned in subsection (1)(a),

(b) the AIFM firm's share of that profit determined under section 850 is the allocated profit (and sections 850A and 850C are to be ignored),

(c) that share is chargeable to tax under Chapter 2 of Part 2 for the tax year in which the period of account ends (with the person liable for the tax charged being the AIFM firm), and

(d) the tax is charged at the additional rate.

(5) The Commissioners for Her Majesty's Revenue and Customs may make regulations modifying any of the following enactments applying to income tax as they apply by virtue of this section in relation to the AIFM firm—

(a) those relating to returns of information and supply of accounts, statements and reports,

(b) those relating to the assessing, collecting and receiving of income tax,

(c) those conferring or regulating a right of appeal, and

(d) those concerning administration, penalties, interest on unpaid tax and priority of tax in cases of insolvency under the law of any part of the United Kingdom.

(6) P's profit determined under section 850, 850A or 850C is "relevant restricted profit" so far as it represents variable remuneration awarded to P—

(a) as deferred remuneration (including deferred remuneration which, if it vests in P, will vest in the form of instruments), or

(b) as upfront remuneration which vests in P in the form of instruments with a retention period of at least 6 months.

(7) In order for any variable remuneration to count for the purposes of subsection (6) it must be awarded to P in accordance with arrangements which are consistent with the AIFMD remuneration guidelines (see section 863H).

(8) In the case of a firm which is an AIFM firm by virtue of section 863D(3)(b) only, this section applies only in relation to partners who fall within a category of staff which is classified as identified staff.

(9) Terms used in subsections (6) to (8) have the same meaning as in the AIFMD remuneration guidelines.

**863F Vesting of remuneration represented by the allocated profit**

(1) Subsection (2) applies if all or a part of the variable remuneration represented by the allocated profit vests in P at a time when P is carrying on the AIFM trade (whether as a partner in the AIFM firm or otherwise).

(2) The amount given by subsection (5) is treated as a profit of the relevant tax year (see subsection (7)) made by P in the AIFM trade chargeable to income tax under Chapter 2 of Part 2.

(3) Subsection (4) applies if all or a part of the variable remuneration represented by the allocated profit vests in P at a time when P is no longer carrying on the AIFM trade (whether as a partner in the AIFM firm or otherwise).

(4) If this subsection applies—

(a) P is treated as receiving, in the relevant tax year (see subsection (7)), income of the amount given by subsection (5),

(b) income tax is charged under this subsection on that income, and

(c) P is the person liable for that tax.

(5) The amount to be treated as a profit or as income received by P is—

(a) the amount of the allocated profit, or the part of it representing the part of the variable remuneration, net of the income tax for which the AIFM firm is liable by virtue of section 863E in respect of the allocated profit or the part of it, plus

(b) an amount equal to so much of that income tax as has been paid by the AIFM firm when the vesting occurs.

(6) Further—

(a) P is treated as paying, when the vesting occurs, an amount of income tax equal to the amount given by subsection (5)(b), and

(b) that amount is accordingly to be taken into account in determining the income tax payable by, or repayable to, P.

(7) "The relevant tax year" is—

(a) if the variable remuneration or the part of it is deferred remuneration, the tax year in which the vesting occurs, or

(b) if the variable remuneration or the part of it is upfront remuneration, the tax year for which the allocated profit would have been chargeable to income tax under Chapter 2 of Part 2 as mentioned in section 863E(1)(b).

(8) Terms used in this section have the same meaning as in the AIFMD remuneration guidelines (see section 863H).

(9) Section 850E (payment from B to A after application of section 850C(4) or 850D(4)) is to be ignored for the purposes of this section.

**863G Vesting statements**

(1) This section applies if all or a part of the variable remuneration represented by the allocated profit vests in P.

(2) If P requests it in writing, the AIFM firm must provide P with a statement showing—

(a) the amount of the allocated profit, or the part of it representing the part of the variable remuneration, gross of the income tax for which the AIFM firm is liable by virtue of section 863E in respect of the allocated profit or the part of it,

(b) the amount of the income tax for which the AIFM firm is liable, and

(c) so much of that amount as has been paid by the AIFM firm when the vesting occurs.

(3) The duty to comply with a request under this section is enforceable by P.

(4) In the case of a limited liability partnership, the duty is enforceable against the body corporate.

**863H The AIFMD remuneration guidelines**

In sections 863E to 863G "the AIFMD remuneration guidelines" means the "Guidelines on Sound Remuneration Policies under the AIFMD" issued by the European Securities and Markets Authority on 3 July 2013 (ESMA/2013/232)."

*Supplementary provision*

15 In Part 2 of TMA 1970 (returns of income and gains) in section 12AB (partnership returns to include partnership statement) after subsection (1) insert—

"(1A) In the case of a partnership which has made an election under section 863D of ITTOIA 2005 (whether or not the election has been revoked), a notice under section 12AA(2) or (3) may require the partnership statement to include such information as is specified in the notice for purposes connected with the operation of sections 863D to 863G of ITTOIA 2005."

16 In Part 3 of TCGA 1992 (which makes special provision about partnerships etc) after section 59A insert—

**"59B Alternative investment fund managers (1)**

(1) Subsection (2) applies if—

(a) under section 863E of ITTOIA 2005, a partner ("P") in a partnership allocates to the partnership an amount of profit ("the allocated profit") representing variable remuneration which, if it vests in P, will vest in the form of instruments,

(b) there is a disposal to P of instruments which are partnership assets of the partnership for the purposes of section 59, and

(c) by virtue of that disposal the variable remuneration vests in P.

(2) Both the persons making the disposal and P are to be treated as if the instruments were acquired by P from those persons for a consideration of an amount equal to the allocated profit net of the income tax for which the partnership is liable by virtue of section 863E of ITTOIA 2005 in respect of the allocated profit.

(3) Terms used in this section which are also used in section 863E or 863F of ITTOIA 2005 have the same meaning as in that section.

**59C Alternative investment managers (2)**

(1) Subsection (2) applies if—

(a) under section 863E of ITTOIA 2005, a partner ("P") in a partnership allocates to the partnership an amount of profit ("the allocated profit") representing variable remuneration which, if it vests in P, will vest in the form of instruments,

(b) there is a disposal to P of instruments by a company which is a partner in the partnership,

(c) by virtue of that disposal the variable remuneration vests in P, and

(d) the company would, as a partner in the partnership, have been charged to tax on the allocated profit but for adjustments made in the case of the company under section 1264A(2) of CTA 2009 or section 850C(5) of ITTOIA 2005.

(2) Both the company and P are to be treated as if the instruments were acquired by P from the company for a consideration of an amount equal to the allocated profit net of the income tax for which the partnership is liable by virtue of section 863E of ITTOIA 2005 in respect of the allocated profit.

(3) Terms used in this section which are also used in section 863E or 863F of ITTOIA 2005 have the same meaning as in that section."

17 In Part 4 of FA 2004 (pensions) in section 189 (relevant UK individual) after subsection (2A) insert—

"(2B) The income covered by subsection (2)(b) includes—

(a) an amount treated as a profit under section 863F(2) of ITTOIA 2005, and

(b) income treated as received under section 863F(4) of that Act."

18 In section 23 of ITA 2007 (calculation of income tax liability) at the end of Step 4 insert—

"See also section 863E of ITTOIA 2005 which provides for certain partnership profits to be charged at the additional rate."

*Power to apply amendments to other types of firms carrying on regulated activities*

19 (1) The Commissioners for Her Majesty's Revenue and Customs may by regulations amend any Act—

(a) so as to apply (with or without modifications), in relation to regulated firms of a specified description, the provision made by the amendments made by this Part, or

(b) so as to make, in relation to regulated firms of a specified description, provision corresponding to the provision made by the amendments made by this Part.

(2) "Regulated firm" means a firm carrying on a regulated activity within the meaning of the Financial Services and Markets Act 2000 (see section 22 of that Act); and "firm" has the same meaning as in ITTOIA 2005 (see section 847 of that Act) (and includes a limited liability partnership in relation to which section 863(1) of that Act applies).

(3) Regulations under this paragraph may—

(a) make different provision for different cases or different purposes;

(b) make incidental, consequential, supplementary and transitional provision and savings.

*Commencement*

20 The amendments made by this Part have effect for the tax year 2014-15 and subsequent tax years.

PART 4

DISPOSALS OF ASSETS THROUGH PARTNERSHIPS

*Income tax*

21 Part 13 of ITA 2007 (tax avoidance) is amended as follows.

22 (1) In Chapter 5A (transfers of income streams) omit section 809AZF (partnership shares).

(2) The amendment made by this paragraph has effect for cases where the transfer of a right to relevant receipts occurs on or after 6 April 2014.

23 (1) After Chapter 5A insert—

**“CHAPTER 5AA**

DISPOSALS OF INCOME STREAMS THROUGH PARTNERSHIPS

**809AAZA Application of Chapter**

(1) This Chapter applies (subject to subsection (2)) if directly or indirectly in consequence of, or otherwise in connection with, arrangements involving a person within the charge to income tax (“the transferor”) and another person (“the transferee”)—

(a) there is, or is in substance, a disposal of a right to relevant receipts by the transferor to the transferee,

(b) the disposal is effected (wholly or partly) by or through a partnership (“the relevant partnership”),

(c) at any time—

(i) the transferor is a member of the relevant partnership or of a partnership associated with the relevant partnership, and

(ii) the transferee is a member of the relevant partnership or of a partnership associated with the relevant partnership, and

(d) the main purpose, or one of the main purposes, of one or more steps taken in effecting the disposal is the obtaining of a tax advantage for any person.

(2) This Chapter does not apply if—

(a) the transferor is the spouse or civil partner of the transferee and they are living together, or

(b) the transferor is a brother, sister, ancestor or lineal descendent of the transferee.

(3) In subsection (1)(a) the reference to a disposal of a right to relevant receipts includes anything constituting a disposal of such a right for the purposes of TCGA 1992.

(4) For the purposes of subsection (1)(b) the disposal might, in particular, be effected by an acquisition or disposal of, or an increase or decrease in, an interest in the relevant partnership (including a share of the profits or assets of the relevant partnership or an interest in such a share).

(5) For the purposes of subsection (1)(c) it does not matter if the transferor and the transferee are not members of a partnership as mentioned at the same time.

(6) For the purposes of subsection (1)(c) a partnership is "associated" with the relevant partnership if—

(a) it is a member of the relevant partnership, or

(b) it is a member of a partnership which is associated with the relevant partnership (whether by virtue of paragraph (a) or this paragraph).

(7) In subsections (1)(c) and (5) references to the transferor include a person connected with the transferor and references to the transferee include a person connected with the transferee.

(8) In this Chapter—

"arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable),

"partnership" includes a limited liability partnership whether or not section 863(1) of ITTOIA 2005 applies in relation to it,

"relevant receipts" means any income—

(a) which (but for the disposal) would be charged to income tax as income of the transferor (whether directly or as a member of a partnership), or

(b) which (but for the disposal) would be brought into account as income in calculating profits of the transferor (whether directly or as a member of a partnership) for income tax purposes, and

"tax advantage" means a tax advantage, as defined in section 1139 of CTA 2010, in relation to income tax or the charge to corporation tax on income.

**809AAZB Relevant amount to be treated as income**

(1) The relevant amount is to be treated as income of the transferor chargeable to income tax in the same way and to the same extent as that in which the relevant receipts—

(a) would have been chargeable to income tax as income of the transferor, or

(b) would have been brought into account as income in calculating profits of the transferor for income tax purposes,

but for the disposal.

(2) In subsection (1) "the relevant amount" is to be read in accordance with section 809AZB(2) and section 809AZB(3) to (6) applies for the

purpose of determining when income under subsection (1) is treated as arising.

(3) For this purpose, in section 809AZB(2) to (6) references to the transfer of the right are to be read as references to the disposal of the right.

(4) If, apart from this subsection and section 809DZB(3)—

(a) both this Chapter and Chapter 5D would apply in relation to the disposal, and

(b) Chapter 5D would give a greater amount of income of the transferor chargeable to income tax,

this Chapter is not to apply in relation to the disposal."

(2) The amendment made by this paragraph has effect for cases where the arrangements mentioned in section 809AAZA(1) of ITA 2007 are made on or after 6 April 2014.

24 (1) After Chapter 5C insert—

"**CHAPTER 5D**

DISPOSALS OF ASSETS THROUGH PARTNERSHIPS

**809DZA Application of Chapter**

(1) This Chapter applies if conditions A and B are met.

(2) Condition A is (subject to subsection (3)) that directly or indirectly in consequence of, or otherwise in connection with, arrangements involving a person within the charge to income tax ("the transferor") and another person ("the transferee")—

(a) there is, or is in substance, a disposal of an asset ("the transferred asset") by the transferor to the transferee,

(b) the disposal is effected (wholly or partly) by or through a partnership ("the relevant partnership"),

(c) at any time—

(i) the transferor is a member of the relevant partnership or of a partnership associated with the relevant partnership, and

(ii) the transferee is a member of the relevant partnership or of a partnership associated with the relevant partnership, and

(d) the main purpose, or one of the main purposes, of one or more steps taken in effecting the disposal is the obtaining of a tax advantage for any person.

(3) Condition A is not met if—

(a) the transferor is the spouse or civil partner of the transferee and they are living together, or

(b) the transferor is a brother, sister, ancestor or lineal descendent of the transferee.

(4) In subsection (2)(a) the reference to a disposal of an asset includes anything constituting a disposal of an asset for the purposes of TCGA 1992.

(5) For the purposes of subsection (2)(b) the disposal might, in particular, be effected by an acquisition or disposal of, or an increase or decrease in, an interest in the relevant partnership (including a share of the profits or assets of the relevant partnership or an interest in such a share).

(6) For the purposes of subsection (2)(c) it does not matter if the transferor and the transferee are not members of a partnership as mentioned at the same time.

(7) For the purposes of subsection (2)(c) a partnership is "associated" with the relevant partnership if—
  (a) it is a member of the relevant partnership, or
  (b) it is a member of a partnership which is associated with the relevant partnership (whether by virtue of paragraph (a) or this paragraph).

(8) In subsections (2)(c) and (6) references to the transferor include a person connected with the transferor and references to the transferee include a person connected with the transferee.

(9) Condition B is that it is reasonable to assume that, had the transferred asset instead been disposed of directly by the transferor to the transferee, the relevant amount (or any part of it)—
  (a) would have been chargeable to income tax as income of the transferor, or
  (b) would have been brought into account as income in calculating profits of the transferor for income tax purposes.

(10) In this Chapter "the relevant amount" means the amount of the consideration received by the transferor for the disposal.

(11) If the transferor receives—
  (a) no consideration for the disposal, or
  (b) consideration which is substantially less than the market value of the transferred asset,

assume for the purposes of subsection (10) that the transferor receives consideration of an amount equal to the market value of the transferred asset.

(12) In subsection (11) references to the market value of the transferred asset are to that value at the time of the disposal.

(13) In this Chapter—

"arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable),

"partnership" includes a limited liability partnership whether or not section 863(1) of ITTOIA 2005 applies in relation to it, and

"tax advantage" means a tax advantage, as defined in section 1139 of CTA 2010, in relation to income tax or the charge to corporation tax on income.

**809DZB Relevant amount to be treated as income**

(1) The relevant amount is to be treated as income of the transferor chargeable to income tax in the same way and to the same extent as that in which it—

(a) would have been chargeable to income tax as income of the transferor, or

(b) would have been brought into account as income in calculating profits of the transferor for income tax purposes,

as mentioned in section 809DZA(9).

(2) Section 809BZB(3) to (6) applies for the purpose of determining when income under subsection (1) is treated as arising (reading references to the transfer of the right as references to the disposal of the transferred asset).

(3) If, apart from this subsection and section 809AAZB(4)—

(a) both this Chapter and Chapter 5AA would apply in relation to the disposal, and

(b) Chapter 5AA would give the same amount, or a greater amount, of income of the transferor chargeable to income tax,

this Chapter is not to apply in relation to the disposal."

(2) The amendment made by this paragraph has effect for cases where the arrangements mentioned in section 809DZA(2) of ITA 2007 are made on or after 6 April 2014.

*Corporation tax*

25 Part 16 of CTA 2010 (factoring of income etc) is amended as follows.

26 (1) In Chapter 1 (transfers of income streams) omit section 756 (partnership shares).

(2) The amendment made by this paragraph has effect for cases where the transfer of a right to relevant receipts occurs on or after 1 April 2014.

27 (1) After Chapter 1 insert—

"**CHAPTER 1A**

DISPOSALS OF INCOME STREAMS THROUGH PARTNERSHIPS

**757A Application of Chapter**

(1) This Chapter applies if directly or indirectly in consequence of, or otherwise in connection with, arrangements involving a company within the charge to corporation tax ("the transferor") and another person ("the transferee")—

(a) there is, or is in substance, a disposal of a right to relevant receipts by the transferor to the transferee,

(b) the disposal is effected (wholly or partly) by or through a partnership ("the relevant partnership"),

(c) at any time—

(i) the transferor is a member of the relevant partnership or of a partnership associated with the relevant partnership, and

(ii) the transferee is a member of the relevant partnership or of a partnership associated with the relevant partnership, and

(d) the main purpose, or one of the main purposes, of one or more steps taken in effecting the disposal is the obtaining of a tax advantage for any person.

(2) In subsection (1)(a) the reference to a disposal of a right to relevant receipts includes anything constituting a disposal of such a right for the purposes of TCGA 1992.

(3) For the purposes of subsection (1)(b) the disposal might, in particular, be effected by an acquisition or disposal of, or an increase or decrease in, an interest in the relevant partnership (including a share of the profits or assets of the relevant partnership or an interest in such a share).

(4) For the purposes of subsection (1)(c) it does not matter if the transferor and the transferee are not members of a partnership as mentioned at the same time.

(5) For the purposes of subsection (1)(c) a partnership is "associated" with the relevant partnership if—

(a) it is a member of the relevant partnership, or

(b) it is a member of a partnership which is associated with the relevant partnership (whether by virtue of paragraph (a) or this paragraph).

(6) In subsections (1)(c) and (4) references to the transferor include a person connected with the transferor and references to the transferee include a person connected with the transferee.

(7) In this Chapter—

"arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable),

"partnership" includes a limited liability partnership whether or not section 1273(1) of CTA 2009 applies in relation to it,

"relevant receipts" means any income—

(a) which (but for the disposal) would be charged to corporation tax as income of the transferor (whether directly or as a member of a partnership), or

(b) which (but for the disposal) would be brought into account as income in calculating profits of the transferor (whether directly or as a member of a partnership) for corporation tax purposes, and

"tax advantage" means a tax advantage, as defined in section 1139, in relation to income tax or the charge to corporation tax on income.

**757B Relevant amount to be treated as income**

(1) The relevant amount is to be treated as income of the transferor chargeable to corporation tax in the same way and to the same extent as that in which the relevant receipts—

(a) would have been chargeable to corporation tax as income of the transferor, or

(b) would have been brought into account as income in calculating profits of the transferor for corporation tax purposes,

but for the disposal.

(2) In subsection (1) "the relevant amount" is to be read in accordance with section 753(2) and section 753(3) and (4) applies for the purpose of determining when income under subsection (1) is treated as arising.

(3) For this purpose, in section 753(2) to (4) references to the transfer of the right are to be read as references to the disposal of the right.

(4) If, apart from this subsection and section 779B(3)—

(a) both this Chapter and Chapter 4 would apply in relation to the disposal, and

(b) Chapter 4 would give a greater amount of income of the transferor chargeable to corporation tax,

this Chapter is not to apply in relation to the disposal."

(2) The amendment made by this paragraph has effect for cases where the arrangements mentioned in section 757A(1) of CTA 2010 are made on or after 1 April 2014.

28 (1) After Chapter 3 insert—

"CHAPTER 4

DISPOSALS OF ASSETS THROUGH PARTNERSHIPS

**779A Application of Chapter**

(1) This Chapter applies if conditions A and B are met.

(2) Condition A is that directly or indirectly in consequence of, or otherwise in connection with, arrangements involving a company within the charge to corporation tax ("the transferor") and another person ("the transferee")—

(a) there is, or is in substance, a disposal of an asset ("the transferred asset") by the transferor to the transferee,

(b) the disposal is effected (wholly or partly) by or through a partnership ("the relevant partnership"),

(c) at any time—

(i) the transferor is a member of the relevant partnership or of a partnership associated with the relevant partnership, and

(ii) the transferee is a member of the relevant partnership or of a partnership associated with the relevant partnership, and

(d) the main purpose, or one of the main purposes, of one or more steps taken in effecting the disposal is the obtaining of a tax advantage for any person.

(3) In subsection (2)(a) the reference to a disposal of an asset includes anything constituting a disposal of an asset for the purposes of TCGA 1992.

(4) For the purposes of subsection (2)(b) the disposal might, in particular, be effected by an acquisition or disposal of, or an increase or decrease in, an interest in the relevant partnership (including a share of the profits or assets of the relevant partnership or an interest in such a share).

(5) For the purposes of subsection (2)(c) it does not matter if the transferor and the transferee are not members of a partnership as mentioned at the same time.

(6) For the purposes of subsection (2)(c) a partnership is "associated" with the relevant partnership if—

(a) it is a member of the relevant partnership, or

(b) it is a member of a partnership which is associated with the relevant partnership (whether by virtue of paragraph (a) or this paragraph).

(7) In subsections (2)(c) and (5) references to the transferor include a person connected with the transferor and references to the transferee include a person connected with the transferee.

(8) Condition B is that it is reasonable to assume that, had the transferred asset instead been disposed of directly by the transferor to the transferee, the relevant amount (or any part of it)—

(a) would have been chargeable to corporation tax as income of the transferor, or

(b) would have been brought into account as income in calculating profits of the transferor for corporation tax purposes.

(9) In this Chapter "the relevant amount" means the amount of the consideration received by the transferor for the disposal.

(10) If the transferor receives—

(a) no consideration for the disposal, or

(b) consideration which is substantially less than the market value of the transferred asset,

assume for the purposes of subsection (9) that the transferor receives consideration of an amount equal to the market value of the transferred asset.

(11) In subsection (10) references to the market value of the transferred asset are to that value at the time of the disposal.

(12) In this Chapter—

"arrangements" includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable), "partnership" includes a limited liability partnership whether or not section 1273(1) of CTA 2009 applies in relation to it, and

"tax advantage" means a tax advantage, as defined in section 1139, in relation to income tax or the charge to corporation tax on income.

**779B Relevant amount to be treated as income**

(1) The relevant amount is to be treated as income of the transferor chargeable to corporation tax in the same way and to the same extent as that in which it—

(a) would have been chargeable to corporation tax as income of the transferor, or

(b) would have been brought into account as income in calculating profits of the transferor for corporation tax purposes,

as mentioned in section 779A(8).

(2) Section 753(3) and (4) applies for the purpose of determining when income under subsection (1) is treated as arising (reading references to the transfer of the right as references to the disposal of the transferred asset).

(3) If, apart from this subsection and section 757B(4)—

(a) both this Chapter and Chapter 1A would apply in relation to the disposal, and

(b) Chapter 1A would give the same amount, or a greater amount, of income of the transferor chargeable to corporation tax,

this Chapter is not to apply in relation to the disposal."

(2) The amendment made by this paragraph has effect for cases where the arrangements mentioned in section 779A(2) of CTA 2010 are made on or after 1 April 2014.

## 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 863C 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.

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 condition A which is that, there are arrangements in place under which M is to perform services for the LLP in M’s capacity as a member of the LLP and it is reasonable to expect that the amounts payable by the LLP for those services will be wholly, or substantially wholly, in the form of disguised salary.

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

7. Subsection (3) of new section 863B defines “arrangements” for the purpose of subsection (1).

8. Subsection (4) of new section 863B details condition B which is that, M does not have significant influence over the affairs of the LLP.

9. Subsection (5) of new section 863B 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 (6).

10. Subsection (6) of new section 863B details the amount that is to be taken into account for the purpose of subsection (5). This is the total amount of disguised salary which,

it is reasonable to expect, will be payable in the relevant tax year by the LLP in respect of M's performance 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".

11. Subsections (7) and (8) of new section 863B detail when the question of whether condition C is met is to be determined or re-determined.

12. Subsection (9) of new section 863B provides that an increase in M's contribution to the LLP which would result in condition C not being met at the time of the change, is not be so treated unless it is reasonable to expect that condition C will not be met at a later time in the tax year.

13. Subsection (10) of new section 863B provides that where condition C is met, it is treated as 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.

14. Subsections (11) and (12) of new section 863B explain what is meant by the term "contribution to the LLP" and how this should be calculated.

15. Subsections (13) to (15) of new section 863B provide for the amount of the contribution to be treated as reduced in certain circumstances.

16. New section 863C contains anti-avoidance rules.

17. Subsection (1) of new section 863C 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.

18. Subsections (2) and (3) of new section 863C 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.

19. Subsection (4) of new section 863C 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.

20. Subsection (5) of new section 863C 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.

21. Subsection (6) of new section 863C defines “arrangements” for the purposes of new section 863C.

22. Paragraph 2 inserts new section 1273A into Part 17 of the Corporation Tax Act 2009 (CTA 2009).

23. New section 1273A applies at any time when new section 863A(2) of ITTOIA 2005 applies and makes corresponding provision for corporation tax purposes.

24. Paragraph 3(2) inserts new section 94AA into Chapter 5 of Part 2 of ITTOIA 2005.

25. 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).

26. Paragraph 3(3) applies new section 94AA of ITTOIA 2005 to property businesses.

27. Paragraph 4(2) inserts new section 92A into Chapter 5 of Part 3 of CTA 2009.

28. 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).

29. Paragraph 4(3) applies new section 92A of CTA 2009 to property businesses.

30. Paragraph 4(4) amends Chapter 2 of Part 16 of CTA 2009 and inserts new section 1227A.

31. 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.

32. Paragraph 5 provides for commencement.

**BACKGROUND NOTE**

33. 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.

34. This element of the partnerships review measure is discussed in the consultation document under the heading: *Disguised Employment.*

35. 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).

## EXPLANATORY NOTE

## PARTNERSHIPS (PART 2): PARTNERSHIPS WITH MIXED MEMBERSHIPS

## SUMMARY

1. Clause [a] and Schedule [b] counter tax advantages arising to individuals in partnership with persons who are not individuals (mixed membership partnerships) by way of excess allocations of profits or losses to certain members.

## DETAILS OF THE SCHEDULE

2. Paragraph (6)(3) inserts new sections 850C to 850E into Part 9 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

3. Subsection (1) of new section 850C provides that the consequences in subsections (4) and (5) apply in the circumstances where an individual ("A") is a partner in a firm that has a profit for a relevant period of account and a non-individual partner ("B") has a profit share and either of conditions X or Y is met.

4. Subsections (2) and (3) of new section 850C detail conditions X and Y. Condition X relates to where A's profit is deferred. Condition Y relates to where A has the power to enjoy B's profit share.

5. Subsection (4) of new section 850C provides the consequences for A if the circumstances and conditions in subsection (1) are met. It explains how A's profit share is to be increased by the amount of B's profit share that can reasonably be supposed to be attributable to A's deferred profit or A's power to enjoy B's profits. The increase in the case of A's power to enjoy B's profits is not to be more than the amount by which B's profit share exceeds B's appropriate notional profit, less any amount that is attributable to A's deferred profit. B's appropriate notional profit is calculated by reference to B's appropriate notional return on capital (as defined in subsection (11)) and appropriate notional consideration for services (as defined in subsection (15)).

6. Subsection (5) of new section 850C provides the consequences for B if the circumstances and conditions in subsection (1) are met and B is subject to income tax. In determining B's profit for a period of account adjustments are to be made to reflect the increase in A's profit share on a just and reasonable basis.

7. Subsection (6) of new section 850C defines an "individual partner" and "non-individual partner". A "non-individual" would include, for example, a company or an individual acting as a trustee.

8. Subsection (7) of new section 850C specifies that B's profit share is to be determined by reference to the income tax rules for calculating a partner's profit share. This is the case whether B is chargeable to income tax or corporation tax.

9. Subsection (8) of new section 850C defines the term "A's deferred profit" used in condition X.

10. Subsection (9) of new section 850C defines the term "the relevant tax amount" used in conditions X and Y.

11. Subsection (10) of new section 850C defines the term "the appropriate notional profit" used in condition Y as the sum of the appropriate notional return on capital and the appropriate notional consideration for services.

12. Subsections (11) and (12) of new section 850C define the term "the appropriate notional return on capital" used in subsection 10 and specify how it is to be calculated by reference to B's contribution to the firm.

13. Subsections (13) and (14) of new section 850C specify how the amount of B's contribution to the firm for the purposes of subsections (11) and (12) is to be determined.

14. Subsections (15) to (17) of new section 850C define the term "the appropriate notional consideration for services" used in subsection 10 and specify how it is to be calculated.

15. Subsection (18) of new section 850C) details the circumstances in which A has the power to enjoy B's profit share. This is the case if A is a connected person in relation to B, other than being connected by reason of being partners in the partnership, or if any of the enjoyment conditions specified in subsection (19) are met in relation to all or part of B's profit share.

16. Subsection (19) of new section 850C details the enjoyment conditions.

17. Subsection (22) of new section 850C applies where all or part of the increase in A's profit share is allocated by A to the firm under new section 863E of ITTOIA 2005, which modifies the rules for the taxation of partnerships that manage Alternative Investment Funds, and B makes a payment representing income tax to the firm. The payment is disregarded in calculating any income of any person for income tax purposes.

18. Subsection (1) of new section 850D provides that the consequences in subsections (4) and (5) apply in the circumstances where a non-individual partner ("B") has a profit share for a relevant period of account, and individual ("A") personally performs services for the firm, it is reasonable to suppose that A would have been a partner in the firm but for the rules in new section 850C and either of conditions X or Y is met.

19. Subsections (2) and (3) of new section 850D set out conditions X and Y. Condition X relates to amounts representing A's deferred profit in B's profit share. Condition Y relates to where A has the power to enjoy B's profit share.

20. Subsection (4) of new section 850D provides the consequences for A if the circumstances and conditions in subsection (1) are met. A is treated as a partner in the firm for the relevant period of account, except for the purposes of new section 863E of ITTOIA 2005, and as having a share of the firm's profit for the relevant period of account which is chargeable to income tax. A's share of the profit is the amount of B's profit that can reasonably be supposed to be attributable to A's deferred profit or A's power to enjoy B's profits. A's share of the profits is not to be more than the amount by which B's profit share exceeds B's appropriate notional profit, less any amount that is attributable to A's deferred profit. B's appropriate notional profit is determined in the same way as in new section 850C of ITTOIA 2005.

21. Subsection (5) of new section 850D provides the consequences for B if the circumstances and conditions in subsection (1) are met and B is subject to income tax. In determining B's profit share for a period of account adjustments are to be made to reflect A's share of the firm's profit on a just and reasonable basis.

22. Subsection (7) of new section 850D specifies that B's profit share is to be determined by reference to the income tax rules for calculating a partner's profit share. This is the case whether B is chargeable to income tax or corporation tax.

23. Subsection (8) of new section 850D provides an automatic assumption in relation to a member of a partnership which is associated with the firm. The assumption is that it is reasonable to suppose that the member would have been a partner in the firm at a time during the relevant period of account, or an earlier period of account, but for the provision contained in new section 850C of ITTOIA 2005.

24. Subsection (9) of new section 850D provides the circumstances in which a partnership is "associated" with the firm.

25. Subsection (1) of new section 850E applies subsection (2) if new section 850C(4) of ITTOIA 2005 applies to increase A's profit share, or new section 850D(4) of ITTOIA 2005 applies to treat A as having a share of the firm's profit, and as a result of an agreement in relation to B's profit share, B makes payment to A which does not exceed the amount of the increase of A's profit share or the amount treated as A's share of the firm's profit. This is subject to the payment not being made with a main purpose of obtaining a tax advantage.

26. Subsection (2) of new section 850E provides that a payment is not to be income of A or B, or a distribution, for income tax purposes.

27. Subsection (3) of new section 850E provides definitions relevant to subsection (1).

28. Paragraphs 7(1) and 7(2) amend the overview of Chapter 3 of Part 4 of Income Tax Act 2007 (ITA 2007).

29. Paragraph 7(3) inserts new section 116A into Chapter 3 of Part 4 of ITA 2007.

30. Subsections (1) to (5) of new section 116A provide that no relevant loss relief is to be given to an individual for a loss made in a trade or profession as a partner where the individual is party to arrangements with a main purpose of ensuring that losses are allocated, or otherwise arise, to the individual, or individuals, rather than a non-individual, with a view to the individual obtaining relevant loss relief. For the purpose of this section it does not matter if the entity who is the non-individual is yet to be formed or participate in the partnership.

31. Subsection (6) of new section 116A defines “arrangements” and “relevant loss relief” for the purposes of this section.

32. Paragraphs 8(1) and 8(2) amend the overview in Chapter 4 of Part 4 of ITA 2007.

33. Paragraph 8(3) inserts new section 127C into Chapter 4 of Part 4 of ITA 2007.

34. Subsections (1) to (5) of new section 127C provide that no relevant loss relief is to be given to an individual for a loss made in a property business as a partner where the individual is party to arrangements with a main purpose of ensuring that losses are allocated, or otherwise arise, to the individual, or individuals, rather than a non-individual, with a view to the individual obtaining relevant loss relief. For the purpose of this section it does not matter if the entity who is the non-individual is yet to be formed or participate in the partnership.

35. Subsection (6) of new section 127C defines “arrangements” and “relevant loss relief” for the purposes of this section.

36. Paragraphs 9(1) and 9(2) amend Part 17 of the Corporation Tax Act 2009 (CTA 2009).

37. Paragraph 9(3) inserts new section 1264A into Part 17 of CTA 2009.

38. Subsections (1) and (2) of new section 1264A provide for the situation where the income tax provisions in new sections 850C(4) or 850D(4) of ITTOIA 2005 apply to increase individual A’s profit share, or to treat A as having a share of the firm’s profit, and a company is non-individual B in relation to A. In determining the company’s profits from the firm for an accounting period adjustments are to be made to reflect the increase in A’s profit share, or the amount of profit treated as A’s share of the firm’s profit, on a just and reasonable basis.

39. Subsection (3) of new section 1264A makes corresponding provision for corporation tax in respect of sections 850C(21) and (22) and section 850E of ITTOIA 2005.

40. Paragraphs 10 to 13 provide commencement rules. The changes will take effect from 6 April 2014 with the exception of anti-avoidance rules concerning tax-motivated profit allocations. These rules come into force on 5 December 2013 in order to protect against risks to tax revenue.

## BACKGROUND NOTE

41. 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.

42. This element of the partnerships review measure is discussed in the consultation document under the headings: *Partnerships with mixed membership – profits and Partnerships with mixed membership - losses.*

43. 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).

## EXPLANATORY NOTE

## PARTNERSHIPS (PART 3): ALTERNATIVE INVESTMENT FUND MANAGERS: DEFERRED REMUNERATION ETC

## SUMMARY

1. Clause [a] and Schedule [b] introduces a mechanism for members of alternative investment fund managers (AIFM) partnerships (including their delegates) to allocate certain 'restricted' profits to the partnership. These are profits that those members cannot immediately access because of requirements under the Alternative Investment Fund Managers Directive (AIFMD) (2011/61/EU) to defer remuneration of 'key staff'.

2. The legislation imposes a charge to tax on these profits at the additional rate of tax (45 per cent) to be paid by the AIFM partnership. It also sets out the capital gains treatment where the partner's remuneration is in the form of instruments in the fund under management.

## DETAILS OF THE SCHEDULE

3. Paragraph 14 inserts new sections 863D to 863H into Part 9 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

4. New section 863D(1) states that section 863E will apply to an AIFM trade of an AIFM firm.

5. Subsection (2) of new section 863D states that the election must be made within 6 months after the end of the first period of account for which the election is to have effect.

6. Subsection (3) contains definitions. An AIFM firm is one which carries on a trade which consists either wholly or mainly of managing one or more alternative investment funds itself, or wholly or partly of doing so as the delegate or sub-delegate of the manager. This trade is the AIFM trade.

7. Subsection (4) links terms used in subsection (3) with regulation 4(2) of AIFM Regulations 2013 (S.I. 2013/1773).

8. New section 863E sets out a mechanism for collection of income tax if the election is made.

9. Subsection 1 of new section 863E applies to the 'relevant restricted profit' of a partner in an AIFM firm. This includes profit which has been reallocated to the partner under the excess profit allocation rules in the new section 850C in Part 2 (subsection (1)(b) of new section 863E).

10. Subsection (2) of new section 863E allows the partner to allocate all or part of the profit of the AIFM trade earned by that partner to the AIFM firm.

11. Subsection (3)(a) of new section 863E excludes the allocated profit from the partner's taxable profit in the period of account.

12. Subsection (3)(b) of new section 863E treats the AIFM firm as if it was a partner in itself.

13. Subsections (4)(a) and (b) of new section 863E stipulate that the firm is subject to income tax on the allocated profit. The profit is treated as chargeable under Chapter 2 of Part 2 ITTOIA for the tax year in which the firm's relevant period of account ends (subsection (4)(c) of new section 863E). The rate of tax payable is the additional rate (subsection (4)(d) of new section 863E).

14. Subsection (5) of new section 863E provides a power for HMRC to make regulations to modify administrative provisions.

15. Subsection (6) of new section 863E defines 'relevant restricted profit'. This definition relies on the concepts derived from the AIFMD remuneration guidelines, which is defined in new section 863H, and which are introduced into these provisions by subsection (9) of new section 863E.

16. The effect of these guidelines and the AIFMD is broadly that certain AIFM firms must defer 40-60 per cent of the variable remuneration of key staff by up to three to five years and pay at least 50 per cent of the variable remuneration in units or shares of the funds they manage, or equivalent ownership interests, rather than cash.

17. 'Relevant restricted profit' includes two categories of variable remuneration. The first category is deferred consideration including remuneration in cash or instruments. The second category is upfront remuneration (i.e. remuneration which is not deferred) which vests in the partner in the form of instruments with a retention period of at least six months.

18. Subsection (7) of new section 863E limits the application of the mechanism to remuneration which is awarded to a partner under arrangements that are consistent with the AIFMD remuneration guidelines.

19. Subsection (8) of new section 863E limits the application of the mechanism in the case of AIFM firms which qualify for the mechanism only because they are delegates of AIFM managers to partners who are 'identified staff' as defined in the guidelines.

20. New section 863F sets out the tax treatment when the relevant restricted profit vests in the partner who initially allocated it to the partnership.

21. Two situations are covered. The first is where at the time the remuneration vests, the partner is still carrying on the AIFM trade, whether as a partner in the firm or otherwise (subsection (1) of new section 863F). In this case, under subsection (2) of new section 863F,

the amount determined by subsection (5) of new section 863F is treated as a profit of the relevant tax year made in the AIFM trade and taxable under Chapter 2 of Part 2 of ITTOIA 2005.

22. The second situation is where the individual in whom the allocated profit vests is no longer carrying on the AIFM trade (subsection (3) of new section 863F). In that case, the individual is not treated as receiving trading income but as in receipt of income liable to income tax in the relevant tax year (subsection (4) of new section 863F). This income is not chargeable Chapter 2 of Part 2 of ITTOIA 2005.

23. The amount which is treated as a profit or income is, under subsection (5) of new section 863F, the amount of the allocated profit net of the income tax for which the AIFM firm is liable plus the amount of that income tax paid by the firm at the time when the vesting occurs.

24. Subsection (6) of new section 863F specifies that the income tax which has been paid by the AIFM firm is credited to the partner in whom the income vests and is taken into account in determining the income tax payable by, or repayable to, that individual.

25. Subsection (7) of new section 863F defines the relevant tax year as the year of vesting, in the case of deferred remuneration, and, in the case of upfront remuneration in the form of instruments, the tax year in which the allocated profit would have otherwise been chargeable to income tax for the partner.

26. Subsection (8) of new section 863F explains that certain terms used in this section take their meaning from the AIFMD remuneration guidelines.

27. Subsection (9) of new section 863F provides that the provisions in the excess profit allocation rules which permits certain adjusting payments to be made without tax consequences is ignored for the purposes of this provision.

28.. New section 863G gives a partner who has allocated profit to an AIFM firm under the mechanism, and in whom the profit then vests, the right to obtain from the firm a statement showing details of the amount of the profits and tax payable and paid.

29. New section 863H defines the AIFMD remuneration guidelines.

30. Paragraph 15 inserts a new section 12AB(1A) into the Taxes Management Act 1970. This gives HMRC the right to require the partnership statement to include information about an election made under new section 863D.

31. Paragraph 16 inserts new sections 59B and 59C into Taxation of Chargeable Gains Act 1992 (TCGA 1992). This applies where allocated profit to which the mechanism applies vests in the partner in the form of instruments.

32. Under the new section 59B, where there has been a disposal to the partner of instruments which are partnership assets for the purposes of section 59 TCGA 1992 and, by virtue of that disposal, the variable remuneration vests in the partner, both the persons

making the disposal and the partner are to be treated as making the disposal and acquisition respectively for an amount equal to the allocated profit net of the tax for which the partnership was liable.

33. New section 59C has the same effect where there is a disposal of instruments by a company which is a partner in the partnership and the company would, as a partner in the firm, have been charged to tax on the allocated profit but for adjustments under the excess profit allocation provisions.

34. Paragraph 17 inserts a new section 189(2B) into Finance Act 2004. This is to ensure that income charged under new section 863F on vesting is also treated as partnership income for pension purposes.

35. Paragraph 18 inserts the charging of AIFM partnership profits into Step 4 in the calculation of income tax liability under section 23 of Income Tax Act 2007.

36. Paragraph 19 gives power to HMRC to make regulations for equivalent provisions to apply in future if necessary to other firms regulated under the Financial Services and Markets Act 2000.

## BACKGROUND NOTE

37. This mechanism is part of a wider review of certain parts of the partnership rules announced at 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.

38. This element of the partnerships review measure is flagged up in the consultation document under the heading: *Partnership with mixed memberships – profits: Profit deferral and working capital arrangements.* Further information was received during the consultation period on the AIFMD issue and the use of mixed membership structures by AIFM partnerships. This was fed into the design of the mechanism.

39. 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).

## EXPLANATORY NOTE

## PARTNERSHIP (PART 4): DISPOSALS OF ASSETS THROUGH PARTNERSHIPS

## SUMMARY

1. Clause [a] and Schedule [b] will prevent tax-motivated disposals of income streams or assets within the charge to tax on income through partnerships giving rise to tax advantages.

2. The legislation will impose a charge to tax on income on the person making the disposal.

## DETAILS OF THE SCHEDULE

*Income tax*

3. Paragraph 21 of the Schedule is introductory.

4. Paragraph 22 omits section 809AZF of Income Tax Act (ITA) 2007, which becomes unnecessary as a result of the new measure.

5. Paragraph 23 (1) inserts new Chapter 5AA into ITA. The Chapter introduces new section 809AAZA, which covers disposals of income streams by persons within the charge to income tax by or through partnerships.

6. New section 809AAZA(1)(a) provides that the Chapter applies if directly or indirectly in connection with arrangements involving a person (the transferor) there is or there is what amounts to a disposal of a right to *relevant receipts* to another person (the transferee) where all of the conditions set out in subsection (1)(b) to (1)(d) are met.

7. Subsection (1)(b) sets out the first condition, which is that the disposal is effected by or through a partnership.

8. Subsection (1)(c) sets out the second condition, which is that the transferor and transferee are at any time (not necessarily the same time) members of the partnership.

9. Subsection (1)(d) sets out the third condition which is that a main purpose of any steps taken in effecting the disposal is to secure a tax advantage for any person.

10. Subsection (2) provides that the legislation does not however apply if the disposal is to a spouse or civil partner or relative of the transferor.

11. Subsection (3) defines disposal as including anything that is a disposal for the purposes of Taxation of Chargeable Gains Act (TCGA) 1992. This includes a part disposal.

12. Subsection (4) provides that the disposal may in particular be effected by an acquisition, disposal or change in a share in partnership profits or assets.

13. Subsection (5) makes clear that transferor and transferee do not have to be members of the partnership at the same time.

14. Subsection (6) puts beyond doubt that the legislation cannot be avoided by means of chains of partnerships.

15. Subsection (7) provides that references to transferor and transferee include persons connected with the transferor or transferee. So if for example the actual transferor of the right to relevant receipts is not a member of the partnership, but a connected person is, then the legislation can apply to the actual transferor provided that the other conditions are all met.

16. Subsection (8) provides definitions. “Relevant receipts” takes its meaning from the transfer of income streams legislation in Chapter 5A of Part 13 ITA 2007, which is income that would otherwise have been taxable income of the transferor. “Tax advantage” means an advantage in relation to income tax or the charge to corporation tax on income.

17. New section 809AAZB(1) sets out the treatment where new section 809AAZA applies. The “relevant amount” is to be charged to tax as income of the transferor in the same way as the relevant receipts would have been.

18. Subsection (2) gives ’relevant amount’ the same meaning as in the transfers of income streams legislation in Chapter 5A of Part 13 of ITA 2007, and also covers the timing of the tax charge. The relevant amount is the consideration given for the income stream, unless the consideration given is much less than the value of the income in which case the charge to tax will be based on a deemed market value disposal.

19. Subsection (4) explains the interaction of new Chapter 5AA with new Chapter 5D of ITA 2007 (Disposals of assets through partnerships). If both apply then new Chapter 5AA will not apply if the charge under new Chapter 5D is greater.

20. Paragraph 23(2) covers commencement of new Chapter 5AA. The legislation applies where the arrangement referred to in new section 809AAZA(1) is made on or after 6 April 2014.

21. Paragraph 24 (1) of the Schedule inserts new Chapter 5D into ITA. The Chapter introduces new section 809DZA, which covers disposals of assets by or through partnerships.

22. New section 809DZA(1) provides that the Chapter applies if both Condition A and Condition B are met.

23. New section 809DZA(2) contains Condition A which is that directly or indirectly in connection with arrangements involving a person (the transferor) there is or there is what amounts to a disposal of an asset in circumstances where subsections (2)(b) to (d) apply.

24. Subsection (2)(b) sets out a requirement that the disposal is effected by or through a partnership.

25. Subsection (2)(c) requires that the transferor and transferee are at any time (not necessarily the same time) members of the partnership.

26. Subsection (2)(d) requires that a main purpose of any steps taken in effecting the disposal is to secure a tax advantage for any person.

27. Subsection (3) provides that the legislation does not however apply if the disposal is to a spouse or civil partner or relative of the transferor.

28. Subsection (4) defines disposal as including anything that is a disposal for the purposes of TCGA 1992. This includes a part disposal.

29. Subsection (5) provides that the disposal may in particular be effected by an acquisition, disposal or change in a share in partnership profits or assets.

30. Subsection (6) makes clear that transferor and transferee do not have to be members of the partnership at the same time.

31. Subsection (7) puts beyond doubt that the legislation cannot be avoided by means of chains of partnerships.

32. Subsection (8) provides that references to transferor and transferee include persons connected with the transferor or transferee. So if for example the actual transferor of the asset is not a member of the partnership, but a connected person is, then the legislation can apply to the actual transferor provided that the other conditions are all met.

33. Subsection (9) contains Condition B which is that it is reasonable to assume that, had the transferred asset been disposed of directly by the transferor to the transferee, the charge to tax on income would have applied to the "relevant amount" received by the transferee.

34. Subsections (10) to (12) define relevant amount as the consideration given for the asset, unless the consideration given is much less than the value of the asset in which case it is the market value.

35. Subsection (13) provides definitions. "Tax advantage" means an advantage in relation to income tax or the charge to corporation tax on income.

36. New section 809DZB(1) sets out the treatment where new section 809DZA applies. The "relevant amount" is to be charged to tax as income of the transferor in the same way as the relevant receipts would have been.

37. Subsection (2) contains timing rules for the taxable amounts based on the transfers of income stream legislation.

38. Subsection (3) explains the interaction of Chapter 5D with new Chapter 5AA (Disposals of income streams through partnerships). If both apply then Chapter 5D will not apply if the charge under Chapter 5AA is greater.

39. Paragraph 24(2) covers commencement. The legislation applies where the arrangement is made on or after 6 April 2014.

*Corporation tax*

40. Paragraph 25 of the Schedule is introductory.

41. Paragraph 26 omits section 756 of Corporation Tax Act (CTA) 2010, which is unnecessary as a result of the new measure.

42. Paragraph 27(1) inserts new Chapter 1A into CTA 2010. The Chapter introduces new section 757A, which covers disposals of income streams by companies by or through partnerships.

43. New section 757A(1)(a) provides that the Chapter applies if directly or indirectly in connection with arrangements involving a company (the transferor) there is or there is what amounts to a disposal of a right to *relevant receipts* to another person (the transferee) where all of the conditions set out in subsection (1)(b) to (1)(d) are met.

44. Subsection (1)(b) sets out the first condition, which is that the disposal is effected by or through a partnership.

45. Subsection (1)(c) sets out the second condition, which is that the transferor and transferee are at any time (not necessarily the same time) members of the partnership.

46. Subsection (1)(d) sets out the third condition which is that a main purpose of any steps taken in effecting the disposal is to secure a tax advantage for any person.

47. Subsection (2) defines disposal as including anything that is a disposal for the purposes of TCGA 1992. This includes a part disposal.

48. Subsection (3) provides that the disposal may in particular be effected by an acquisition, disposal or change in a share in partnership profits or assets.

49. Subsection (4) makes clear that transferor and transferee do not have to be members of the partnership at the same time.

50. Subsection (5) puts beyond doubt that the legislation cannot be avoided by means of chains of partnerships.

51. Subsection (6) provides that references to transferor and transferee include persons connected with the transferor or transferee. So if for example the actual transferor of the right to relevant receipts is not a member of the partnership, but a connected person is, then the legislation can apply to the actual transferor provided that the other conditions are all met.

52. Subsection (7) provides definitions. “Relevant receipts” takes its meaning from the transfer of income streams legislation in Chapter 1 of Part 16 ITA 2007, which is income that would otherwise have been taxable income of the transferor. “Tax advantage” means an advantage in relation to income tax or the charge to corporation tax on income.

53. New section 757B(1) sets out the treatment where new section 757A applies. The “relevant amount” is to be charged to tax as income of the transferor in the same way as the relevant receipts would have been.

54. Subsection (2) gives ‘relevant amount’ the same meaning as in the transfers of income streams legislation, and also covers the timing of the tax charge. The relevant amount is the consideration given for the income stream, unless the consideration given is much less than the value of the income in which case the charge to tax will be based on a deemed market value disposal.

55. Subsection (3) stipulates that references to the transfer of the right in the transfers of income streams legislation are to be read as references to the disposal of the right.

56. Subsection (4) explains the interaction of Chapter 1A with new Chapter 4 (Disposals of assets through partnerships). If both apply then Chapter 1A will not apply if the charge under Chapter 4 is greater.

57. Paragraph 27(2) covers commencement. The legislation applies where the arrangement is made on or after 1 April 2014.

58. Paragraph 28(1) inserts new Chapter 4 into CTA. The Chapter introduces new section 779A, which covers disposal of assets by or through partnerships.

59. New section 779A(1) provides that the Chapter applies if both Condition A and Condition B are met.

60. New section 779A(2) contains Condition A which is that directly or indirectly in connection with arrangements involving a company (the transferor) there is or there is what amounts to a disposal of an asset in circumstances where subsections (2)(b) to (d) are met. .

61. Subsection (2)(b) sets out a requirement that the disposal is effected by or through a partnership.

62. Subsection (2)(c) requires that the transferor and transferee are at any time (not necessarily the same time) members of the partnership.

63. Subsection (2)(d) states that a main purpose of any steps taken in effecting the disposal is to secure a tax advantage for any person.

64. Subsection (3) defines disposal as including anything that is a disposal for the purposes of TCGA1992. This includes a part disposal.

65. Subsection (4) provides that the disposal may in particular be effected by an acquisition, disposal or change in a share in partnership profits or assets.

66. Subsection (5) makes clear that transferor and transferee do not have to be members of the partnership at the same time.

67. Subsection (6) is intended to put beyond doubt that the legislation cannot be avoided by means of chains of partnerships.

68. Subsection (7) provides that references to transferor and transferee include persons connected with the transferor or transferee. So if for example the actual transferor of the asset is not a member of the partnership, but a connected person is, then the legislation can apply to the actual transferor provided that the other conditions are all met.

69. Subsection (8) contains Condition B which is that it is reasonable to assume that, had the transferred asset been disposed of directly by the transferor to the transferee, the charge to corporation tax on income would have applied to the "relevant amount" received by the transferee.

70. Subsections (9) to (11) define relevant amount as the consideration given for the asset, unless the consideration given is much less than the value of the asset in which case it is the market value.

71. Subsection (12) provides definitions. "Tax advantage" means an advantage in relation to income tax or the charge to corporation tax on income.

72. New section 779B(1) sets out the treatment where new section 779A applies. The "relevant amount" is to be charged to tax as income of the transferor in the same way as the relevant receipts would have been.

73. Subsection (2) contains timing rules for the taxable amounts based on the transfers of income stream legislation.

74. Subsection (3) explains the interaction of Chapter 4 with new Chapter 1A (Disposals of income streams through partnerships). If both apply then Chapter 4 will not apply if the charge under Chapter 1A is greater.

75. Paragraph 8(2) covers commencement. The legislation applies where the arrangement is made on or after 1 April 2014.

**BACKGROUND NOTE**

76. 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.

77. This element of the partnerships review measure is discussed in the consultation document under the heading: *Partnership members with differing tax attributes.*

78. 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).

# Partnerships: A review of two aspects of the tax rules

**Technical Note and Guidance**
10 December 2013

# Contents



**On request this document can be produced in Welsh and alternative formats including large print, audio and Braille formats**

# 1. Introduction

On 20 May 2013, HM Revenue and Customs (HMRC) issued a document[1] consulting on the detailed design of the change proposals to tackle tax loss in the areas below:

a) **Disguised employment in Limited Liability Partnerships (LLPs)**

New legislation will be introduced to tax individual LLP members who are in substance employees of the LLP ('Salaried Members') as employees.

b) **Tax-motivated allocation of business profits & losses in partnerships**

New legislation will be introduced to remove the tax advantages gained through tax-motivated:

i) profit allocations to non-individual partners;
ii) loss allocation to individual partners; and
iii) transfers of assets or income streams through partnerships.

The legislation now published also includes new provisions to deal with certain tax consequences of the Alternative Investment Fund Managers Directive (AIFMD) (2011/61/EU). The consultation closed on 9 August 2013.

All four pieces of legislation – disguised employment, mixed membership partnerships (profits/losses), AIFMD and asset disposals - will be included in the Finance Bill 2014 and will take effect from 2014/15. To prevent avoidance, certain provisions in the mixed membership rules come into force from the date they were first published (5 December 2013). The full set of draft legislation was published on 10 December along with a consultation response document, explanatory notes and this note.

This note provides guidance on the legislation and explains how it will work by reference to practical examples. It will, in due course, form the basis of guidance to be included in HMRC Manuals.

HMRC invites comments on this guidance, including in particular further practical examples which it would be useful to incorporate.

Following the extensive consultation already undertaken, the Government would not expect to make significant changes to the published legislation, although comments on technical details would be welcome.

However, in relation to the Salaried Members legislation, HMRC would welcome comments on whether there are further scenarios the guidance should cover or on any clarifications that should be included in the legislation itself. In particular, HMRC would welcome comments on whether Condition C (capital contributions) of the Salaried Member legislation can be simplified, whilst continuing to deliver the policy objectives.

[1] HMRC published a consultation document, *Partnerships: A review of two aspects of the tax rules,* on GOV.UK website*:* https://www.gov.uk/government/consultations/a-review-of-two-aspects-of-the-tax-rules-on-partnerships

# 2. The Salaried Members Legislation

## A guide to this chapter



## 2.1. What is this about?

As was explained in the consultation document, there is evidence that LLPs are increasingly being used and marketed to avoid employment taxes.

LLPs set up under UK legislation are bodies corporate that combine the organisational flexibility of traditional partnerships with the benefit of limited liability for their members.

The policy intention when LLPs were introduced was that they would be treated for tax purposes as if they were traditional partnerships rather than being subject to corporation tax as would be normal for a body corporate.

This means that individual members are taxed on their share of the profits of the LLP, in the same way that individual partners in a traditional partnership are taxed.

However, the rules on who can be a member of an LLP are wider than those for a partner in a traditional partnership. Consequently a number of LLPs have adopted reward strategies for their members that are modelled on those for employees rather than partners.

The result is that many LLPs have members engaged on terms more closely resembling those of employees, who work for the business, than of traditional partners, who carry on the business.

The Salaried Member legislation is being introduced so that those members who are effectively in the position of employees will be taxed as employees whilst those members who are in a position equivalent to partners will continue to have the same tax treatment as partners.

## 2.2. Interpretation

CTA means the Corporation Tax Act 2010

ITA means the Income Tax Act 2007.

ITEPA means the Income Tax (Earnings and Pensions) Act 2003.

ITTOIA means the Income Tax (Trading and Other Income Act) 2005. All statutory references are to ITTOIA unless otherwise stated.

LLP means a UK Limited Liability Partnership formed under the Limited Liability Partnership Act 2000 and LLPA means the Act.

SORP means the Statement of Recommended Practice Accounting by Limited Liability Partnerships

## 2.3. Overview

This section gives an overview of when a member of a LLP is treated as an employee for tax purposes.

The Salaried Member test consists of three conditions which, if met, deem the member to be an employee (a Salaried Member) for tax and national insurance purposes.

**Condition A** considers the manner in which the individual is rewarded for his or her performance of services to the LLP. A Salaried Member will have a reward package that is largely that which an employee would have. This means they will be substantially remunerated through a fixed salary or a variable bonus based on their performance, rather than a share of the profits of the overall business; for more detail on this point, see section 2.4.2 below.

**Condition B** ensures that an individual will not be a Salaried Member if he or she has a significant say in the running of the business as a whole; see section 2.4.3 below.

**Condition C** looks at the capital contribution made to the LLP by the individual. A partner in a traditional partnership risks losing money if the business fails. To reflect this, an individual will not be a Salaried Member if he or she has invested an amount of money in the LLP that is at least 25% of their expected income from the LLP, which is fixed or variable income for a tax year as described under Condition A. For further information on this, see section 2.4.5 below.

To summarise, if an individual is a member of an LLP and:

- the reward for their performance of services as a member of the LLP is fixed, or variable without reference to the firm's profits, rather than a share of the profits of the LLP as a whole,
- they have no significant say in the running of the business as a whole, and

- they have no significant money investment in the business.

then that individual is a Salaried Member and will be treated as an employee, subject to PAYE and to tax on any benefits in kind.

There is anti-avoidance legislation on Salaried Members to counteract attempts to circumvent the new rules. An overview of this legislation is at section 2.6 below.

## 2.4. The test and conditions (S863B)

### 2.4.1. How does it work?

The Salaried Member provisions are intended to apply to those members who are more like employees than partners in a traditional partnership. The overall approach of these provisions is intended to be similar to the wide-ranging tests that would be applied in determining whether a particular person was a partner in a traditional partnership, but differences will occur as the provisions apply a mechanical approach to the most significant factors in order to provide a more certain outcome.

The starting point is to look at the terms and conditions for that particular member. These will be set out in the LLP Agreement. HMRC has set out guidance on the LLP Agreement in the Business Income Manual at BIM82112.

In looking at whether a member is a Salaried Member, the agreement between the member and the LLP by which that member joined the LLP (including the agreement constituting the LLP if it is different), will be important together with any side agreements that the member has entered into.

The Salaried Member legislation sets out three conditions. In order for an individual to be classified as a Salaried Member, **all three conditions** must be satisfied.

The Salaried Members rules only apply to LLPs formed under the LLPA. They do not apply to general partnerships or to limited liability partnerships formed under the law of jurisdictions outside the UK, even if the firm is operating in the UK. In these cases, the general law (and not the Salaried Members legislation) will apply to determine the status of an individual as an employee or partner.

### 2.4.2. Condition A - payment for provision of services (S863B (1)-(3))

The Salaried Member provisions are intended to apply to those members who are more like employees than partners in a traditional partnership.

Condition A is the most significant of the three Conditions that determine whether an individual is a Salaried Member. It is intended to identify those members who, at first sight, are working for the LLP on terms that are like those of employees; that is, they are paid for their services without reference to the overall profitably of the firm.

**a. Provision of services** (S863B(1)(a))

The Salaried Member provisions only apply where an individual is working for the LLP.

This means that the Salaried Member provisions do not apply to:

- companies; or
- individuals who do no more than invest money.

**b. Capacity**

In addition, the individual has to carry out that work for the LLP as a member.

The legislation does not apply to any reward that an individual member obtains for work performed for the LLP in a separate capacity, for example as part of a separate business.

There is anti-avoidance legislation that counters artificial attempts to separate the work of the member from the LLP: see section 2.6 below.

*Example 1:*

> *The B LLP is formed between the B family and a local developer to develop a plot of land. Kate B is a member of the B LLP, but under the LLP agreement, she does not need to work for the B LLP.*
>
> *Kate B is an architect and engaged by B LLP to draw up plans in her capacity as an architect, for which she is paid an arm's length fee under a separate contract.*

In this case, Condition A is not satisfied. Whilst Kate B is a member who performs services for the LLP, she does not perform those services as a member of the LLP. The B LLP has contracted for her to provide services as part of her profession as an architect and her reward from the LLP all arises to her in that capacity .

**c. Wholly or substantially wholly** (S863B(1)(b))

Condition A is met if the member is working for the LLP and it is reasonable to expect that the payment for their services will be wholly or substantially wholly in the form of what is called a "*disguised salary*".

*Substantially wholly* is not defined in the legislation. In practice, HMRC would consider Condition A to be met if 80% or more of the amounts payable to the individual for services to the LLP are expected to be in the form of a disguised salary.

**d. Reasonable to expect** (S863B(1)(b))

It is important to note that the condition is framed in terms of the amounts that it is reasonable to expect the LLP to pay to the member. This is a question that should be answered by reference to the substance of the matter taking a realistic view of the facts.

Those rewards that are unrealistic and are unlikely ever to be triggered are ignored.

The question of when something is realistic is considered at point k below.

**e. Disguised salary** (S863B(2))

The legislation sets out what is a disguised salary:

> *"An amount is "disguised salary" if it - .*
>
> > *(a) is fixed,*
> > *(b) if it is variable, is varied without reference to the overall amount of the profits or losses of the limited liability partnership, or*
> > *(c) is not, in practice, affected by the overall amount of those profits or losses."*

A disguised salary comprises amounts that are independent of the overall profitability of the firm. It includes:

- a fixed sum such as a salary;
- payment on a piece work basis - by the number of units produced or jobs done - for more information on "personal performance", see point g;
- a bonus based on a member's personal performance rather than the success of the business - for more information on "personal performance", see point g;
- guaranteed profit - for more information on guaranteed profits, see point j;
- non-refundable drawings - for more information on when drawings are treated as a disguised salary, see section point j.

*Example 1A:*

> *J works for the ABC LLP. He will receive a salary of £100,000 plus a bonus determined by a remuneration committee, at their discretion.*

For the purposes of this legislation, the question is what are the terms governing the remuneration committee’s exercise of its discretion in determining the bonus payable. If the bonus is paid out of shares of the profit, then that is a share of the profit for the purposes of the legislation.

In this case, more information is needed - what are the terms of reference for the committee? How realistic is it that any profit share will be 25% or more than the fixed salary of £100,000 (such that 80% of the total rewards will be).

**f. Profit share** (S863B(2)(b))

Condition A is not met if it is expected that the member will be largely rewarded by a share of the profits of the business carried on by the LLP.

A share of the profit of the business does not include a bonus by reference to the success of a particular sector, such as a shop, or how well an individual's own client portfolio has done. It is by reference to the business as a whole.

**g. Personal performance** (S863B(2)(b))

Condition A will be satisfied where the individual member receives a payment that is based on their own personal performance, rather than a share of the profits of the business as a whole.

A bonus based on the performance of the individual is not a profit share. It is variable but is:

> *"varied without reference to the overall amount of the profits or losses of the limited liability partnership"*

This guidance looks at examples to illustrate the distinction between rewards for personal or team success as opposed to share of a profit of the business.

**h. Performance pay**

If a member is paid a fixed amount plus a bonus on the basis of the success of a particular branch or unit (but has no further reward), then Condition A is satisfied.

**i. Payments linked to piece work or turnover**

If a member is paid on a "piece work" basis, that is on the basis of the number of tasks they perform or pieces of work they do, Condition A is satisfied.

A payment by reference to the number of tasks performed or by reference to turnover is variable but it is:

> *"varied without reference to the overall amount of the profits or losses of the limited liability partnership"*

Partners carry on a business in common and receive shares of the profits, not shares of the turnover.

*Example 2:*

> *W LLP operates sites offering "hand car washes". The individuals who wash the cars are members of the LLP rather than being given contracts of employment. Member D washes cars at one of these sites. Member D is paid on a piece work basis; the more cars washed, the more he receives.*

Member D will earn more if more cars come to be washed. However his income is based on his work, not the success of the business as a whole. Member D receives a disguised salary and Condition A is satisfied.

*Example 2A***:**

> *The XYZ LLP decides to expand into a new business area. A new member, P, is recruited to run the new business area.*
>
> *As it is expected that the new business area will initially make a loss, P will receive a guaranteed profit share of £100,000 plus a percentage of the turnover of the new business area.*

Neither the guaranteed profit share nor the payment based on a percentage of the turnover of that business area is based on the profits of the LLP as a whole. Condition A is satisfied.

## j. Guaranteed profits and drawings

A disguised salary includes both fixed amounts and amounts that are determined without reference to the level of profits or losses for the LLP as a whole.

As a result, a disguised salary includes any sum that the member is reasonably expected to receive whether or not the LLP makes sufficient profit.

The key point is not how the payment is described; rather that it is a sum that the member expects to receive and will not in practice vary with the profit even if it is expressed to be linked to profit. It may be theoretically possible that a member is required to repay part of their drawings, or that the firm may make a loss, but if these are unlikely events, they will be ignored.

Here are some examples of arrangements which will be regarded as guaranteed profits:

- *Member A is entitled to draw a salary of £10,000 a month.*
- *Member B is entitled to draw £10,000 a month. Under the terms of the agreement, he cannot be required to repay the money once drawn.*
- *Member C has a guaranteed profit of £120,000 a year.*
- *Member D is entitled to draw £10,000 a month. Realistically D will not be asked to refund this sum.*

The reality is that all four members are entitled to £120,000; the level of profits does not affect this part of their reward package.

*Example 3:*

> *A is a member of the ABC LLP. Part of his reward package is that he is allowed drawings of £10,000 a month. Under the terms of the agreement he does not have to refund this, even if the LLP makes a loss.*

A is treated as receiving a disguised salary of £120,000 as he will receive this irrespective of the profit of loss.

> *B is also a member of the ABC LLP. B can draw £10,000, but this is only an advance on his profit share. If the profit, after payment of non-refundable drawings of other members, is insufficient he will need to repay money to the LLP. If his share of profit is in the end more than £10,000 he will be entitled to a further payment.*

B's drawings are not a disguised salary. The timing of payments is not relevant to Condition A.

**k. Practical likelihood** (S863B(2)(c))

The Salaried Member provisions look at the expected amounts payable to that individual member. It is important to identify the real package on offer.

If the agreement provides for a member to receive a share of the profit or loss but it is not reasonable to expect that those terms will have any practical effect, then these terms are ignored.

*Example 5:*

> *Four people decide to set up a cafe together. Members A, B & C do not have any capital to invest so only put in £100 each. The fourth, Member D, provides the funding for the venture.*
>
> *They agree that Members A, B & C will each have a salary of £25,000 a year. The agreement is that these are not repayable even if the profits are under £75,000.*
>
> *Any loss would fall to Member D, who will receive the first £125,000 of profits after payment of salaries. Profits above that will be divided equally.*

Members A, B & C all potentially have a share of the profits, the question is how realistic is that possibility?

For Members A, B & C to receive a profit share at all, the profits need to be in excess of £200,000.

If the business plan is based on an expectation of profits of between £100,000 and £150,000, then there is no reasonable expectation that the income of Members A, B & C will be significantly affected by the level of profits and Condition A is satisfied.

**I . Apply the test on the facts at that time**

The test depends on how realistic the allocations are at the time of the agreement.

If we look again at example 5:

> *The business plan suggests that it is realistic that Members A, B & C will receive sufficient profit share so that they are not Salaried Members. However, heavy rain washes part of the road away restricting access, so turnover is a fraction of forecast. Members A, B & C only receive their salaries and no profit share.*

The test is not revisited with the benefit of hindsight. Although as events have turned out they have received only a salary, this is only the result of a chain of unforeseen events. As they expected and intended to mainly have a profit share, they are not Salaried Members.

## 2.4.3. Condition B – significant influence (S863B(4))

The legislation states:

> *Condition B is that the mutual rights and duties of the members of the limited liability partnership, and of the partnership and its members, do not give M significant influence over the affairs of the partnership.*

A partnership is a group of people who are carrying on a business in common with a view to profit. In short, the partners are the business.

Condition B in section 863B (4) is that the mutual rights and duties of the members of the limited liability partnership, and of the partnership and its members, do not give M significant influence over the affairs of the partnership.

Condition B is in essence looking at the role played by the individual in the business. Put simply, can it be said that the individual is the business rather than merely working for the business?

The affairs of the partnership to be considered are more than voting for the managing committee or the firm's accounts and look at whether there is significant influence over the business, as a whole, rather than individual components of the business.

Condition B is likely to be particularly important for the members of smaller LLPs.

*Example 6:*

> *The Family Farm LLP has as members, a couple, A & B, and their adult son, X. The LLP Agreement has not been amended since before X was admitted. The way that the LLP operates in practice is that A, B and X all have a say in the running of the business, with A having a casting vote.*

Although the written agreement was not amended when X was admitted, the implied terms of the agreement under which X was admitted was that he would have a significant say in the business. As a result, Condition B is not satisfied and X is not a Salaried Member.

It is unlikely that this Condition will exclude many members of very large partnerships, since, in such cases, it is likely that only a minority of individuals have significant influence over the affairs of the whole partnership.

### a. Hierarchy of members

The terms under which people become members will vary. It is not uncommon for there to be almost a hierarchy of membership.

The question is: what are the terms of each class of membership? This should be shown by the LLP Agreement, including the appropriate documentation under which an individual became a partner.

### b. Management committee

Some LLPs delegate management to a part of the membership.

The LLP Agreement usually indicates what and how powers are so delegated.

If the members of the management committee effectively run the LLP, then Condition B will not be satisfied in respect of those members. Condition B will be satisfied for the remaining members, who are potentially Salaried Members.

*Example 7:*

> *Up until 1 June 2014, E was the managing partner of GH LLP, a large professional services firm. Upon reaching the age of 60, E decided that she wanted to retire. F was appointed as the new managing partner but F and the other members were keen to retain E's experience in order to mentor F and provide a smooth transition.*
>
> *E agreed to carry on as a member for a further year, becoming the firm's chairperson. She would continue to be an integral member of the management committee in this period, providing direction to F and the other members, albeit reducing her hours at work.*
>
> *E would withdraw her capital from the firm over the course of the year in order to purchase a second home in the south of France. It was also agreed that her profit share would largely be fixed for this period, even though it had been entirely variable up until 1 June 2014.*

Will E be a salaried member in her final year with the firm?

Although it seems that Conditions A and C of the test could be met in light of her move from a variable to a fixed profit share and the withdrawal of her capital, the circumstances are that she will clearly have significant influence over the affairs of the partnership for the whole of this period. Therefore, Condition B will not be met, meaning that Conditions A and B will not need to be considered; E will not be treated as a salaried member.

### c. Part of a business

The test applies to the business as a whole. If an individual runs part of the LLP, such as a specific branch or shop, but has no say in the business as a whole then Condition B will be satisfied and the individual may be a Salaried Member.

## 2.4.4. When to apply Conditions A and B

For individuals who are members at 6 April 2014, the test needs to be applied at that point.

For individuals who become members after 6 April 2014, the test needs to be applied at the date on which they become members.

Once the tests have been applied, then they do not need to be applied again until there is a change of circumstances that mean that the result may change.

*Example 8:*

> *A currently satisfies Condition A, he receives a disguised salary. A negotiates a pay rise so that his salary rises by £5,000.*

There is no need to test to see if Condition A continues to be satisfied. The pay rise will not affect whether the test is satisfied.

*Example 9:*

> *B currently satisfies Condition A, she receives a disguised salary. B negotiates revised conditions, so that she surrenders £10,000 and instead receives 5 units. At the end of the period, the residual profit is divided by the number of units that have been awarded. In effect, each unit represents a part of the residual profit.*

More of B's reward is now calculated by reference to the profits of the LLP. Condition A needs to be re-tested.

## 2.4.5. Condition C – contribution to the LLP (S863B(5))

The legislation states:

> *"Condition C is that, at the time at which it is being determined whether the condition is met (the relevant time), M's contribution to the limited liability partnership is less than 25% of the amount given by subsection (6)."*

Condition C looks at the level of investment in the LLP by that member. Has the member made a significant investment in the business so they have a real risk resting on the success or failure of the business?

The test is whether the amount contributed is less than 25% of the <u>disguised salary</u> expected to be payable for the whole tax year. If the member has contributed less than 25%, then Condition C is satisfied and that member may be a Salaried Member.

**a. The time at which it is determined whether Condition C is met**

The initial time at which the test in Condition C is applied is set out at sub section (7), which states:

> *"The question of whether condition C is met is to be determined.*
>
> > *(a) at the beginning of the tax year 2014-15 or, if later, the time at which M becomes a member of the limited liability partnership;*
> > *(b) after that, at the beginning of each tax year."*

The test is also applied if there is a change in the year, subsection (8) states:

> *"If in a tax year.*
>
> > *(a) there is a change in M's contribution to the limited liability partnership, or*
> > *(b) there is otherwise a change of circumstances which might affect the question of whether condition C is met,*
>
> *the question of whether the condition is met is to be re-determined at the time of the change."*

There is no need to retest if Condition C was not previously met and all that has happened is that the individual has increased their contribution.

## **b. What is the contribution?** (ITA/S108 and ITTOIA/S863B(11))

The amount of capital contribution is based on the amount that the individual has invested as capital at that time in accordance with the LLP Agreement.

- It does not take into account sums that the individual may be called upon to pay at some future date.
- It does not take into account undrawn profits unless by agreement they have been converted into capital.
- It does not take into account sums that are held by the LLP for the member, for example, sums held in a taxation account.
- It does not take into account amounts of capital that are part of arrangements to enhance the amount of capital to enable the individual to "avoid" being a Salaried Member where there is no intention that they have permanent effect or otherwise give rise to no economic risk to the member.

*Example 10*:

*P has:*

- *£10,000 contributed as capital in accordance with the LLP Agreement;*
- *£50,000 long term "loan". Interest is paid on this but otherwise the amount is held on terms comparable to the capital, e.g. the loan is only repayable when P resigns, or the LLP is wound up. The amount is treated for tax purposes as a share of the profit;*
- *£30,000 as a short term loan for a two year term;*
- *£25,000 undrawn profits – that can be withdrawn at any time; and*
- *£25,000 in a tax reserve current account to pay the tax on P's profit share.*

P is entitled to withdraw the short term loan, undrawn profits and the sum in the tax reserve current account, whilst he remains a member. These are not part of the capital contributed (ITA/S108(5)(C)). P cannot withdraw either the sum described as capital or that described as a "loan". These are both intended for the long term financing of the firm. P has capital of £60,000.

### **c. Becoming, or ceasing to be, a member part way through the year** (S863B (13)-(15))

Condition C is applied on the basis of the level of disguised salary for the tax year (subsection (6)).

If an individual becomes a member part way through the tax year, then the amount of the contribution is reduced to reflect the number of days in the tax year that the individual will be a member.

If the test is applied at a time when it is expected that the individual will cease to be a member before the end of the tax year, then the amount of the contribution is reduced to reflect the number of days in the tax year that the individual is expected to be a member.

*Example 11:*

*M is appointed a member three months into the tax year. His reward package means that he we will be due a fixed amount of £40,000 for the rest of the tax year (his "disguised salary"). The terms of his membership mean that he had to make a capital contribution of £12,000.*

At first sight, M's contribution may appear to be at least 25% of his disguised salary (12,000/40,000 x 100 = 30%).

However, he will only be a member for 9 months of the current tax year. His capital contribution is, therefore, reduced to reflect the period of the year that he will be a member: 12,000 x (9/12) = £9,000.

When we apply the test using this reduced figure (9,000/40,000 x 100 = 22.5%), Condition C is satisfied.

**d. A change in the contribution part way through the year**

As mentioned under point (a) above, a change in the amount of the contribution may require the test to be reapplied.

A member may increase their contribution during the tax year, with the result that Condition C is from that time no longer met. However, the Condition will continue to be met unless it is reasonable to expect that the Condition will remain not met for the rest of the tax year. This means that it must be reasonable to expect that the increase will be a permanent one that will not later be reversed in the tax year.

In addition, the increased contribution is reduced on a pro rata basis where the increase incurs part way through a tax year.

## 2.5. General examples

The examples in this section look at the way that the Salaried Member test is applied as a whole, rather than looking at the way that the separate conditions apply to the individual.

To ensure that the examples are as realistic as possible, they have been based upon the scenarios put to HMRC as part of the consultation over the summer.

*Example 12:*

It is important to look at the specific facts.

> *50 people currently work for the A LLP, of whom forty-five are listed as members.*
>
> *The A LLP business plan is inclusive, recognising that everyone working for the business is contributing to the success of the business; hence once it is clear that the individual is going to stay with the business, they are invited to become a member.*
>
> *Of the forty-five members, 15 are professionally qualified, five of whom qualified in the last 5 years whilst 3 other members are working for their professional qualifications. The remainder have no intention of becoming professionally qualified.*

The Salaried Member test is **not** concerned with experience or professional qualifications. It looks at the role that individual plays in the business.

> *Under the LLP agreement each member is entitled to an equivalent to statutory sick pay, maternity/paternity leave, holiday entitlement and termination rights.*

Although these may make the partner look like an employee, they are **not** taken into account in the Salaried Member test.

> *Each member receives a profit share. The proportion varies from member to member, but everyone knows that if the business makes less profit they will have less income and if it makes a loss they get nothing*.

All the members, from secretary to the founders know that their income from year to year depends on the level of profit. If the firm makes a loss, then they have no income for the year. This means that Condition A is not satisfied. No member of the A LLP is a Salaried Member and no further action is needed.

*Example 13:*

B LLP is similar to A LLP, but only the 5 senior members receive profit shares, the rest have non-refundable drawings and a nominal profit share, so that 90% of their income is disguised salary and they will meet Condition A.

> *The B LLP is largely a people business using rented accommodation. However, it does need capital. Each of the members has made a contribution, varying with their position in the firm, but starting at £1000.*

Whether Condition C is satisfied depends upon the amount contributed by the member. Condition C will be satisfied unless the capital is at least 25% of the expected reward package for the tax year.

In the case of B LLP, all members satisfy Condition C.

> *Each of the members has a share of the proceeds in the event of winding up.*

This is not a factor in the Salaried Member test.

> *Management of B LLP is delegated to a Management Board, consisting of 9 members who are professionally qualified (these include the 5 senior members who receive profit shares), and the Office Manager, also a member of the LLP, who has no professional qualifications. The other members have no real say in the business.*

The 10 members of the Management Board do not satisfy Condition B. They are not Salaried Members. The fact that the Office Manager is not professionally qualified does not matter; the key is that the role gives the individual significant control.

So in two similar businesses, no member of A LLP is a Salaried Member as all receive only profit shares.

Only 10 members of B LLP are not Salaried Members, the five who both receive profit shares and have control and five others who have significant control.

*Example 14:*

> *C LLP was founded by two individuals, A & B. A & B are entitled to the residual profits, make all the major decisions and they have invested all but a nominal amount of the capital.*
>
> *The other members receive a fixed monthly sum plus an annual discretionary bonus, typically 20% to 30% of the first charge.*

The other members are all Salaried Members, satisfying Conditions A, B & C. Whilst the bonus is sometimes more than 20% of the reward package, this is a discretionary bonus, not linked to the profits. In addition, the individuals have no real influence and no capital contribution.

> *After a while, as had been the intention, C & D, two of the junior members, start to take on elements of the work done by A & B.*

As their terms have changed, the test needs to be applied again to C & D.

> *C & D will receive a lower monthly sum, and instead will receive a share of the profits. A reasonable estimate is that about 25 to 30% of their reward package will be in the form of a profit share. They will also take part in all major decisions.*

C & D have sacrificed an entitlement to salary in exchange for the opportunity to participate in the business in much the same way as A & B the senior partners, even if as junior partners they are substantially rewarded by a fixed profit share. Conditions A and B are no longer met so C & D are no longer Salaried Members.

*Example 15:*

> *The XYZ LLP typically has about 100 members.*
>
> *Existing employees can be invited to become junior members. As a junior member, they initially introduce £4,000 as capital and receive "4 units". The unit is the measure by which residual profits are allocated. As a comparison, the senior partner has 150 units.*
>
> *Junior members are awarded a fixed guaranteed profit share, plus the profit from their units. For a junior member, the profit share under the unit system will be no more than 5% to 10% of the total package.*
>
> *The firm's management power is centralised in a management board formed by the senior members.*

The junior members satisfy all three conditions, they have less than 10% of their reward package as a variable profit share, nominal capital only and no real say.

> *Catherine has been a junior member but is being promoted. She will sit on the management board and have a real say in the running of the business. In*

*addition, she will receive more units but it is still reasonable to expect that less than 20% of her reward package will be variable.*

Catherine has accepted an opportunity to participate in the business in much the same way as a senior member, even if, as a relatively junior member, she is still substantially rewarded by a fixed profit share. Catherine would still satisfy Condition A but is not a Salaried Member as she now does not satisfy Condition B.

## **2.6. Anti-Avoidance** (S863C)

The anti-avoidance legislation is intended to prevent people using artificial structures or arrangements to place members outside the scope of the Salaried Member provisions.

It is not avoidance if the terms under which an individual is a member change and they become a member on genuine terms comparable to a partner in a traditional partnership.

The legislation also prevents the misuse of the Salaried Member provisions as part of a scheme or arrangement to avoid the impact of the mixed membership partnership provisions.

### **2.6.1. Avoidance arrangements (**S863C(1))

In deciding whether an individual is a Salaried Member, any arrangements are ignored where they have been put in place with a main purpose of ensuring that someone is not a Salaried Member.

This applies whether the arrangements have been put in place for one, or for a group of members.

*Example 16:*

*W is a junior member of the ABC LLP and she has only a nominal capital invested. Conditions A and B are satisfied. W receives a non recourse loan to raise her capital so that Condition C is not satisfied. In reality, the money makes its way back in a circle to the lender*

The main purpose of the loan is to enable W to avoid being a Salaried Member. The additional capital is ignored, Condition C is satisfied and W is a Salaried Member.

The position would be unchanged if the arrangements were put in place for one or one hundred members. A main purpose is to enable a member, or a number of members, avoid being a Salaried Member.

*Example 17:*

*P has been an employee of the DEF LLP. She has reached that point in her career where she is offered membership.*

*In order to become a member, P needs to invest in the LLP. She has some capital of her own, and the LLP arranges with the Bank for her to have a normal commercial loan to cover the balance. An undertaking is given that on P's retirement from DEF LLP, the firm will pay back the loan directly out of P's capital account and, if necessary, any undrawn remuneration, with full recourse against P if these amounts prove insufficient.*

These arrangements have been put in place to enable P to become a full member of the DEF LLP. They have not been put in place to enable P to evade being a Salaried Member. P faces genuine risk, she has invested in the DEF LLP and does owe the Bank money, which she will need to repay and, in the interim, she will have to pay interest.

Becoming a full member, on terms akin to those of a partner in a traditional partnership, is not avoiding being a Salaried Member.

### 2.6.2. Use of intermediaries (S863C (2) and (4))

If an individual works for the LLP and, to avoid being a Salaried Member, enters into arrangements so that someone else, such as a company, becomes a member and receives amounts due to the individual then:

- the individual is treated as a Salaried Member,
- the sum paid to the actual member in relation to the individual's services is treated as being paid to the individual, and
- the sum is treated as employment income of the individual.

*Example 18:*

*J realises that he would be a Salaried Member. With the agreement of the LLP, he introduces as a member J Ltd. J Ltd receives the reward package that had been agreed for J.*

These arrangements have been entered into to avoid the impact of the Salaried Member legislation. J is deemed to be the member, the result is that the sum due to J Ltd is treated as payable to J, and PAYE should be operated accordingly.

### 2.6.3. Interaction with mixed membership partnership legislation

The Salaried Member legislation does not apply where an individual would otherwise be a Salaried Member because of arrangements that have a main purpose of securing that the mixed membership partnership legislation does not apply (S850C).

## 2.7. Deductions in respect of Salaried Members

(S94AA, S272, and CTA/S92A & S210)

If a member is a Salaried Member then the costs of employing that individual are expenses of earning profits in the same way as the costs of employing any other individual.

The result is that they are allowable deductions in the same way and the same period as the expenses in respect of any regular employee.

Where the costs of employing the Salaried Member would not be deducted in arriving at the profits of the LLP under normal accounting practice (SORP), a specific statutory deduction is available for tax purposes as explained below.

**2.7.1. Trades & property businesses**

For a trade or property business where the sum is not treated by the SORP as a deduction in arriving at the profits, and it is not otherwise disallowable under general rules, then a statutory deduction is allowed in arriving at the profits of the LLP in the period when the sum is paid.

**2.7.2. Investment companies**

This section looks at the position where the profits of the LLP under CTA09/S1259 are calculated as for an investment company.

If costs of employing a Salaried Member would be expenses of management of a company's investment business but are not referable to an accounting period, they are treated as referable to the accounting period in which they are paid. The availability of a deduction for the payment is then subject to the normal management expenses rules.

## 2.8. Returns

As the Salaried Member is not treated as a partner for tax purposes, they are not included on the Partnership return for a period that they are a Salaried Member.

If the status of an individual changes and they are treated as a partner for part of the period, then they need to be included for that part period.

This means that an individual who is found to be a Salaried Member would be on the Partnership Return for the period up to 5 April 2014, and they would be treated as ceasing as a partner on that date.

## 2.9. Capital assets

Where, after applying the tests in sections 863A and 863B, an individual is treated as a Salaried Member, the legislation applies to treat all amounts received by that individual as employment income subject to the applicable income tax rules under ITEPA. Class 1 and 2 National Insurance contributions (NICs) may also apply.

A Salaried Member is subject to the same rules on taxable benefits received as any other employee.

This treatment does not include any amounts received by a Salaried Member in respect of capital assets of the LLP that would not be taxable as employment income if received by an employee, such as dividends from shares held by the firm.

The interest received by a Salaried Member when becoming a member of the LLP is not itself considered to be a benefit for income tax purposes.

# 3. Partnerships with Mixed Membership

## A guide to this chapter



## 3.1. What is this about?

One attraction of partnerships and LLPs is that they are seen as offering greater flexibility than other business structures, such as limited companies. Sometimes individual partners/members try to use the flexibility of partnerships and LLPs to obtain a tax advantage, using mixed membership partnerships. Draft legislation published with this note counters the following tax-motivated arrangements:

**a) Excess profit allocation**

Individual members may reduce their tax liability by diverting all or part of their profit share to a non-individual member who will pay less tax on that profit share, usually a company. The rules allow the profit sharing arrangements agreed by the partners/members to be over-ridden so that individual members are taxed on profits that have been diverted in such circumstances. The legislation does not apply to mixed membership partnerships in which the individual and non-individual partners are genuinely acting at arm's length.

**b) Excess loss allocation**

Tax avoidance arrangements may be entered into with a view to individual members being allocated losses of the partnership in order for them to be able to claim relevant loss relief to reduce their total tax liability. The rules ensure that relief for the losses will be restricted in such cases.

This part of the note explains how these provisions work.

## 3.2. Interpretation

All terms included in section 2.2 (Salaried Members Legislation: interpretation) apply.

"AIFM" or "AIFMs" means alternative investment fund managers.

AIFMD' means the Directive on Alternative Investment Fund Managers (Directive 2011/61/EU).

FCA means Financial Conduct Authority.

Non-individual means any person other than an individual. It includes an individual acting as trustee.

## 3.3. Excess profit allocation

### 3.3.1. Overview

This section provides an overview of the legislation.

The legislation applies where there is a mixed membership partnership or LLP.

A mixed membership partnership is simply a partnership or LLP that has, as partners or members, both individuals and persons who are not individuals. Examples of non-individuals include companies, trustees or LLPs.

**a. Summary of when the legislation applies**

The legislation applies where the partnership or LLP makes a profit for tax purposes, a profit share is allocated to a non-individual partner and either:

- the profits represent deferred profit of an individual member ("A"), or
- an individual partner (A) meets the "power to enjoy" condition set out in section 850C(18) to (20) in relation to any element of the profit share allocated to the non-individual partner ("B")..

For further information on this point, see section 3.3.6.

In both cases, it must be reasonable to assume that A's profit share is less than it would be apart from the profit deferral arrangements or the circumstances that lead to the power to enjoy condition being met, and that, overall, less tax is paid because of the allocation of profits to the non-individual.

**b. Summary of what the legislation does**

Instead of being taxed on their profit shares as allocated), the shares are adjusted so that:

- A is taxed on the profits that they would have been allocated to A had the profit deferral arrangements not been entered into or that reflect A's power to enjoy the profits allocated to the non-individual, as determined on a just and reasonable basis.

- The non-individual is taxed on a smaller share to reflect the amount the individual is taxed on.

In cases other than deferred profit arrangements (for which it is not relevant), the maximum additional profit that the individual can be taxed on is the difference between the appropriate notional profit for the non-individual and the profit allocated to that non-individual (the non-individual's "excess profit"). For further guidance on what is the appropriate notional profit, see section 3.3.5.

For this purpose (and the purpose of reallocating profits), income tax rules are applied to the calculation of the non-individual's excess profit even if it is, in fact, a company.

If the profit shares of a number of individuals have been allocated to the same non-individual member, then the difference between the excess profit is reallocated amongst the individual partners on a just and reasonable basis. This would, in practice, depend on the facts but, in the absence of evidence that some other basis of apportionment is appropriate, the starting position would be that the excess profit should be reallocated in the same proportions as the actual allocated profit shares in that period.

For examples on how the legislation works, see section 3.3.12.

For guidance on what to do when the money passes from the non-individual to the individual, see section 3.3.11.

There is anti-avoidance legislation which applies where people try to avoid this legislation by the use of intermediary structures, see section 3.3.14.

## 3.3.2. Introduction – key features (S850C)

The excess profit allocation rules apply where profits are diverted from the individual member to a non-individual member.

The guidance on when the legislation applies can be found at section 3.3.3.

The guidance on calculating the amount of profit that is re-allocated is at section 3.3.10.

The reallocated profits are taxed on the relevant individual member(s), but the profits remain in the hands of the non-individual member. The legislation allows for the profits to pass from the non-individual member to the individual without further tax being due. For guidance on this, see section 3.3.11.

For examples on how the legislation works, see section 3.3.12.

Guidance on how this legislation interacts with the legislation on AIFMs can be found at section 3.3.13.

There are provisions that prevent people from avoiding the impact of the legislation. The guidance on this can be found at section 3.3.14.

Guidance on commencement provisions is at section 3.3.15.

### 3.3.3. When does the legislation apply? (S850C (1)-(5))

This section looks at when the excess profit allocation rules apply.

The legislation applies where:

- in a period of account, a partnership has a taxable profit;
- a share of the profit is allocated to a non-individual member;
- Condition X or Y is met; and
- as a result, an individual member's profit share and the relevant tax amount is lower than it would be had the profits been allocated to that individual instead (see section 3.3.8).

The legislation sets out Conditions X and Y as follows:

> *"Condition X is that it is reasonable to suppose that -*
> *(a) amounts representing A's deferred profit (see subsection (8)) are included in B's profit share, and*
> *(b) in consequence, both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would otherwise have been.*
>
> *Condition Y is that -*
> *(a) B's profit share exceeds the appropriate notional profit (see subsections (10) to (17)),*
> *(b) A has the power to enjoy B's profit share (.A's power to enjoy.) (see subsections (18) to (20)), and*
> *(c) it is reasonable to suppose that -*
> > *(i) the whole or any part of B's profit share is attributable to A's power to enjoy, and*
> > *(ii) both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would have been in the absence of A's power to enjoy."*

In brief, Condition X applies where amounts representing the individual member's deferred profit are included in the non-individual member's profit share (see section 3.3.7).

.
Condition Y applies where:

- the non-individual member's profit share exceeds its appropriate notional profit (see section 3.3.5 below);
- the individual member has the power to enjoy the profit share allocated to the non-individual member (see section 3.3.6 below); and
- it is reasonable to suppose that the non-individual member's profit share is, in part at least, attributable to the individual member's power to enjoy it (see section 3.3.7 below).

There are also anti-avoidance provisions to counter arrangements designed to circumvent the rules. For guidance, see section 3.3.14.

### 3.3.4. Non-individual partners (S850C (6))

A non-individual partner is simply anyone other than an individual.

As a result, the term non-individual partner includes companies, partnerships, LLPs and individuals acting as trustees.

*Example 19:*

> *AA LLP is a UK firm that has set up a business in Australia. AA LLP cannot operate in Australia for legal reasons. Instead, the business in Australia is operated through a general partnership AA GP. The two firms work closely together, with a number of individuals being members of both AA LLP and AA GP.*

AA LLP is not a mixed membership partnership. All the members are individuals. The legislation does not distinguish between a member resident in the UK and one resident abroad.

*Example 20*:

> *The INV LLP has a property business. It has 15 individual members, including X. In addition to being an individual member, X is also a member as Trustee of the XXX Settlement.*

The INV LLP is a mixed membership partnership as it has 15 individual members and X in his capacity as trustee of the XXX Settlement.

#### a. Alternative Investment Fund Managers (AIFM) (S863D)

Under the legislation dealing with the tax treatment of remuneration of members of AIFM partnerships or their delegates, the partnership may elect to be treated as a partner in itself in order to pay tax on a member's remuneration on behalf of the member. If it does so, the AIFM firm is treated as an individual member of the partnership, not as a non-individual member for the purposes of the mixed membership rules.

For further information, see the AIFM guidance at Chapter 4.

### 3.3.5. **Appropriate notional profit** (S850C (10)-(17))

For the legislation to apply, the profit share of the non-individual member has to be greater than the appropriate notional profit (S850C(3)(a)).

The appropriate notional profit is made up of two elements:

- the appropriate notional return on capital; and
- the appropriate notional consideration for services.

**a. The appropriate notional return on capital** (S850C (11)-(12))

The appropriate notional return on capital is simply a commercial rate of interest on the capital contributed. This is not a specific rate as the appropriate commercial rate will vary:

- The commercial rate will reflect the level of risk involved.
- Where the level of capital varies during the relevant period of account, the notional return must be calculated from time to time and on these varying amounts.

If the member receives some other form of return on capital, other than a share of the profit (for example, a fee), then this is deducted in arriving at the limit on the notional return.

*Example 21:*

> *B Ltd has invested £10,000 in the ABC LLP. It receives no return on this other than its profit share.*

ABC LLP is paying 2% on loans on the commercial market, reflecting its good credit rating. This represents a commercial rate, so B Ltd has an appropriate notional return on capital of £200.

**b. The appropriate notional consideration for services** (S850C (15))

This is the arm's length value of any services provided by that member for the period, less any other amount received for those services (for example, a service fee) that is not part of the profit share.

In almost all cases, this notional consideration should be no more than the cost to the company in providing the services plus a modest mark-up.

If any services provided involve other members of the partnership, then the value of these services is not included in arriving at the notional return (Section 850C(16)).

*Example 22:*

> *Continuing with the example 21 above, B Ltd is a member of ABC LLP and provides advertising services for ABC LLP. The work is carried out by A, who is also a member of ABC LLP. B Ltd provides no other services to ABC LLP.*

B Ltd is treated as providing no services as the only service provided involves another member of the LLP. Therefore, the appropriate notional consideration for services is nil.

As such, B Ltd has an appropriate notional profit of £200, consisting purely of its notional return on capital.

### 3.3.6. Enjoying the profit (S850C(18))

For the legislation to apply, the individual has to be in a position to enjoy the profit that has been allocated to the non-individual member.

The test for whether the individual can enjoy the profits allocated to the non-individual member is widely drawn.

A person has the power to enjoy profits of another if either of two conditions is met:

- the parties are connected, or
- any of the enjoyment conditions are satisfied.

**a. Connected parties** (S850C(18)(a))

The individual is in a position to enjoy the profits of the non-individual partner if they are connected persons within the definition at ITA07/S993, other than simply being connected through being partners.

*Example 23:*

> *A and A Ltd are the members of A LLP. A controls A Ltd.*

As A controls A Ltd, A and A Ltd are connected and, as such, A has the power to enjoy any profits of A LLP which are allocated to A Ltd.

If they are only connected under ITA07/S993(4) (as partners in the same partnership), then the individual is not in a position to enjoy the profits under the connected person test.

*Example 24:*

> *A and B Ltd are the partners in the AB partnership. A has no interest in B Ltd, which is wholly owned by B, who is not connected to A.*

A and B Ltd are only connected by being fellow partners in the AB partnership. As such, they are not connected and the excess profit allocation rules do not apply.

**b. Enjoyment conditions (S850C (19))**

These conditions look at whether the individual, or a person connected to the individual, is in a position to enjoy the benefit of the profit share allocated to the non-individual. The test is widely drawn but does not include all partnerships with mixed membership, as shown by the example below.

*Example 25:*

> *A farm in Scotland is run as a partnership between the tenant farmer and a limited company owned by the landlord, who is not connected to the tenant.*

This is a mixed membership partnership, but the legislation does not apply as the individual does not benefit from the sums allocated to the company.

## 3.3.7. The profit shares (S850C(3)(c))

In cases where profit deferral arrangements are in place, the legislation will apply if it is reasonable to assume that the individual member's share of the firm's profit is smaller than it would otherwise have been as a result of those arrangements.

In cases where the power to enjoy condition is met, then it must also be reasonable to suppose that the profits of the non-individual partner are higher because of the individual's power to enjoy them.

The individual may have an interest in the non-individual partner but this may be so small that it is clear that the profit share has not been altered as a result.

*Example 26:*

> *MMM LLP has as members, A, B and C, together with X Plc. A has a small investment in X Plc as part of a share portfolio. B has a small investment as she used to work for X Plc and received the shares under an incentive scheme. There are no other arrangements by which they can benefit from the profit share of X Plc*

It would be unrealistic to say that the profit share of X Plc has been increased because A and B have shares. Their holdings are such that they could not have influenced the allocation of profits to C Plc.

If the particular facts show that any economic connection between the individual and non-individual members does not result in profit being shifted from the individual partners to the non-individual, the mixed membership partnership legislation will not apply.

One example is where the non-individual partner has been carrying on the trade for many years before it is transferred into an LLP.

*Example 27:*

> *Oldco Ltd had been trading for many years. A few years ago P, the owner of Oldco Ltd decided that he wants to retire He set up an LLP, whose members are P, Oldco Ltd and a number of individuals whom he hoped would take over the business.*
>
> *Oldco Ltd receives the profit share agreed when the business was transferred to the LLP. This share reflects its founding role in the business and is based on the fact that it contributed the business to the LLP.*
>
> *P receives a small personal profit share that is commensurate with the work he does.*

The facts show that Oldco Ltd receives a profit share reflecting the fact that it transferred its business to the LLP (and that the same profit share would have been received by Oldco Ltd if P fully withdrew from the business, including as an LLP member). Looking at these facts, the legislation would not apply.

## 3.3.8. Relevant tax amount (S850C(2)(b))

The profit allocation legislation only applies where it is reasonable to say that the "relevant tax amount" is lower than it would have been had the profit shares not been diverted from the individual member to a non-individual member.

**a. Relevant tax amount (S850C(9))**

The relevant tax amount is the tax that would have been payable by:

- the individual on the profit share that they were allocated; and
- the non-individual partner on the profit share, as originally allocated.

*Example 28:*

> *The PQR LLP only has individuals as members, so it is not a mixed membership partnership.*
>
> *The members decide to ring-fence a new business venture. They set up Sub LLP. The members of Sub LLP are PQR LLP and those individual members of PQR LLP involved in the project.*
>
> *Profits allocated by Sub LLP to PQR LLP are in turn allocated to the members of that firm all of whom are individuals resident in the UK.*

Sub LLP is a mixed partnership as one of the members is an LLP, which is not an individual. However, the Mixed Membership partnership legislation will not apply. All the profits are allocated to, and taxed upon individual members. In this case the relevant tax amount is not lower as a result of the structure

### 3.3.9. Deferred profit arrangements (S850C(2))

The mixed membership partnership legislation also applies where profits are not allocated to the individual, but instead are held back for whatever reason, and are initially allocated to a non-individual member instead, with the result that the tax paid in that period is lower than it would have been if the profits had been allocated to the individual.

Deferred profit arrangements include arrangements that include the possibility that events may mean that the individual may not actually receive the profits (Section 850C(8)).

*Example 29:*

> *Kate is a member of XYZ LLP. She is awarded a bonus that is conditional upon the successful outcome of a project she has been involved in. The bonus is initially allocated to XYZ Corporate Member Ltd.*

This is a deferred profit arrangement; the fact that it is conditional upon a future event does not alter this.

The AIFMD, its (non-tax) legislation and the FCA rules may prevent AIFMs from accessing their profit shares. There are special provisions for the deferred profit shares of these individuals. For guidance on this, see Chapter 4.

### 3.3.10. Reallocating the profits (S850C (4))

This section looks at how the amount of profits to be reallocated is calculated.

**a. Increase in the individual's profit share**

The individual's profit share is increased by the amount of his or her deferred profit or by the amount by which their profit is less than it would have been apart from the power to enjoy profits of the non-individual, as determined on a just and reasonable basis.

In deferred remuneration cases, the amount to be reallocated is simply the amount of the deferred profit, so far as is just and reasonable.

In cases other than deferred remuneration arrangements, there is a limit to the amount by which the individual's profit share can be increased.

This limit is the amount by which the non-individual partner's profit share exceeds their appropriate notional profit, i.e. the excess profit. For guidance on the appropriate notional profit see section 3.3.5.

In addition, the increase must be reduced by any increase that has been made in the case of that individual in respect of any reallocation of deferred profit.

Often the same non-individual partner will be allocated the profit shares proper to a number of individual partners, for example, where there are deferred profit arrangements for a group of individuals.

Where the same non-individual partner is allocated the profit shares proper to a number of individual partners, the limit by which a particular member's share can be increased is the amount by which that individual's share is lower than it would have been absent the power to enjoy or the existence of profit deferral arrangements.

However, the total amount to be reallocated to individuals cannot exceed the excess of non-individual member's actual profit share over its appropriate notional profit return. If the total exceeds this amount, then the profit that can be reallocated is split between the individual members on a just and reasonable basis. As noted above, in the absence of other detail, the starting position would be that the excess profit should be reallocated in the same proportions that those individuals have actually been allocated profit shares in that period.

**b. Adjustments to non-individual's profits** (S850C(5) and CTA/S1264A)

As the individual is now being taxed on part of the profit share allocated to the non-individual member, the taxable profit share of the latter has to be reduced, so that the profits are taxed in full, but only once.

There may be differences between the way that the taxable profits are calculated for individual and non-individual members, in particular, due to different computational rules for income tax and corporation tax. Therefore, rather than simply reducing the profit share of the non-individual member by the amount by which the individual members' profit shares are increased, an adjustment may need to be made, on a just and reasonable basis.

### 3.3.11. Payment from the non-individual to the individual (S850E)

Although profits may be reallocated for tax purposes, the reality is that the relevant profit share was allocated to the non-individual member. At some point, the money will need to pass to the individual. The legislation provides a rule to prevent the same profits being taxed twice.

If under an agreement:

- the non-individual makes a payment, or series of payments, to the individual out of the profit share allocated to the non-individual, and
- the payment, or series of payments, does not exceed the additional amount that the individual was taxed on,

then the payment is not taken into account for calculating the income of either the individual or non-individual.

The sum is not treated as a distribution for tax purposes (S850E(2)(b)).

This rule does not apply if the payment is part of a scheme or arrangement one of whose main purposes is to obtain a tax advantage.

*Example 30:*

> *A and his company A Ltd are members of the ABC LLP. A has been taxed on £50,000, which had initially been allocated to A Ltd. A Ltd makes a payment of £45,000 to A.*

The sum is paid from the profits allocated to A Ltd; it is less than the sum on which A was taxed.

The sum is ignored for tax purposes; it is not treated as A's income.

### 3.3.12. General examples

This section provides examples of how the mixed membership partnership rules apply.

*Example 31:*

> *The membership of ABC LLP consists of three individuals, A, B and C, who decide that they want to retain funds in the LLP for working capital. In order to avoid the retained profits being taxed at higher income tax rates, they introduce a corporate member, ABC Ltd, which is fully owned by A, B and C.*
>
> *ABC Ltd does not provide any services and only a nominal amount of capital. A, B and C work out what they wish to draw personally and allocate the balance of the profit to ABC Ltd. The profit share allocated is invested or retained in the partnership by the company member as additional partnership capital or advances.*

The individual members are in a position to enjoy the sums allocated to their company.

The three individual members are taxed on an additional profit, split on a just and reasonable basis, equal to the profit share allocated to ABC Ltd, less a sum that represents an appropriate notional return on the nominal amount of capital introduced by ABC Ltd..

*Example 32:*

> *D is a member of DEF LLP. With the agreement of the other members, D introduces as a member, D Ltd, a company that is owned by his wife. D continues as a member, only now he does some work for the LLP through D Ltd. D Ltd provides only a nominal amount of capital.*
>
> *The only change is that the profit share, previously allocated to D, is now allocated partly to D himself, but mainly to D Ltd.*

D Ltd is owned by the wife of D, so a connected person is in a position to enjoy the profits of D.

D is taxed on an additional profit equal to the profit share allocated to D Ltd. Whilst D Ltd is providing services to DEF LLP, the reality is that the work is such services as are being provided by D, another member. These services are ignored in determining the appropriate notional consideration for services. D Ltd provides no other services, so the appropriate notional consideration for services is nil.

### 3.3.13. Interaction with AIFM deferral arrangements

The mixed membership partnership legislation is applied before the profit deferral arrangements legislation applicable to Alternative Investment Fund Managers described in Chapter 4 of this note.

*Example 32A:*

> *X is due a profit share of £100,000 which is to be deferred under the AIFM rules.*
>
> *The firm allocates this deferred profit to a corporate member*

The mixed membership partnership legislation applies and this £100,000 is re-allocated to X.

*Example 32B:*

> *The firm has made an election so that "relevant restricted profits" can be allocated by individual members to the firm*
>
> *The individual allocates their deferred profits of £100,000, allocated to them under the profit allocation rules, to the firm. As the firm is treated as an individual, there is no re-allocation from the firm back to the individual under the mixed membership partnership rules.*

The firm pays tax on that amount in accordance with the AIFM legislation.

### 3.3.14. **Anti-avoidance** (S850D)

Section 850D applies where an individual carries out work for a partnership or LLP and their role looks like the role that you would expect a partner or member to have, but they are not themselves a member.

Irrespective of the complexity of the structure, the legislation will apply if:

- the individual (A) carries out work for the partnership or LLP,
- at that time A is not a member/partner
- a non-individual is a member/partner and receives a profit share

- it is reasonable to suppose that A has “the power to enjoy” the profit share allocated to the non-individual or that the profit share includes deferred profits in relation to A; and
- it is reasonable to suppose that A would have been a partner in the absence of the excess profit allocation rules.

If the legislation applies, then the individual is treated as if they were a member of the partnership or LLP.

The “reasonable to suppose” test (i.e. that A would have been a partner but for the excess profit allocation rules) is treated as met if the non-individual member is itself a partnership.

The mixed membership partnership test is then applied and the individual is taxed on the appropriate amount of the profits reallocated to them.

*Example 33:*

> *X, Y, Z and XYZ Ltd are the members of the XYZ LLP. In response to the new legislation, they decide that all the individual members should cease to be members of the LLP with effect from 6 December 2013 being replaced by their personal service companies.*

X, Y & Z continue to work for the XYZ LLP, it is reasonable to suppose that they would have continued to be members but for the introduction of the legislation.

Under S850D, X, Y & Z are treated as members and the mixed membership partnership legislation applied accordingly.

Their share of the firm’s profit, determined under the mixed membership rules, is chargeable to income tax for the tax year in which the relevant period of account ends. Assuming this period straddles the 6 April 2014 (the date the legislation comes into effect), then this period is split into two notional periods with the latter having a commencement date of 6 April 2104. Only the profits attributable to this latter period will actually be re-allocated to X, Y & Z.

*Example 34:*

> *M, N, O and MNO Ltd are the members of the MNO LLP. In response to the new legislation, they decide that from 1 April 2014 all the individual members should become members of the MNO New LLP. From 1 April 2014, the members of MNO LLP will be MNO Ltd and MNO New LLP. Whilst M, N & O are the members of the MNO New LLP.*

Under S850D (8), it is assumed that M, N & O would have been members of the MNO LLP. The mixed membership partnership legislation applies on the basis that they are deemed to have been members of the MNO LLP.

### 3.3.15. Commencement

The mixed membership partnership legislation applies to periods of account commencing on or after 6 April 2014.

There are special rules which apply where a period of account begins before 6 April 2014 and ends on or after 6 April 2014.

You look at the period from 6 April 2014 to the end of the period of account. If the mixed membership partnership legislation does not apply, then you do not need to take action.

If the mixed membership partnership legislation does apply, then the profits have to be calculated as if there were two notional periods of account, one ending on 5 April 2014 and the second commencing on 6 April 2014. The notional periods of account are only to be taken into account for the purposes of the mixed membership partnership rules.

## 3.4. Excess loss allocation (ITA/S116A and S127C)

### 3.4.1. Overview

Partnerships and UK LLPs are governed by the agreements between the partners/members. This allows flexibility in the arrangements for allocating profits and losses. The excess loss allocation rules are designed to counter avoidance arrangements using mixed membership partnerships, which aim to secure the availability of tax losses to individuals.

In a typical case, arrangements are made between a company and wealthy individuals, where the individuals will contribute funding to a business venture in return for the losses generated in the early years of the partnership, perhaps through capital allowances. The losses will be less valuable to the company than to the individuals, who are taxable at higher income tax rates. When the business becomes profitable, the individual members will have their contribution returned and they will withdraw from the partnership.

The rules ensure that individuals do not get tax relief where there are tax-motivated arrangements in place which mean that losses are allocated to the individual, or a group of individuals, rather than to a company or other non-individual in order to gain a tax advantage.

### 3.4.2. When do the loss restrictions apply? (ITA/S116A (3) and S127C (3))

The legislation states that:

> ***"127C Excess loss allocation to partners who are individuals***
> *(1) Subsection (2) applies if -*

*(a) in a tax year, an individual ("A") makes a loss in a UK property business or an overseas property business as a partner in a firm, and*
*(b) A's loss arises, wholly or partly -*
*(i) directly or indirectly in consequence of, or*
*(ii) otherwise in connection with, relevant tax avoidance arrangements.*
*(2) No relevant loss relief may be given to A for A's loss".*

These restrictions apply when:

- an individual makes a trading or property business loss as a partner in a firm;
- which arises, wholly or partly, as a consequence or in connection with tax avoidance arrangements to which the individual is a party, a main purpose of which is to secure that losses are allocated or arise to the individual, rather than a non-individual; and
- with a view to the individual obtaining relief for the loss.

The fact that the non-individual is not a partner in the firm or is unknown or does not exist at the time does not prevent the restriction applying.

The restrictions do not apply where the partnership/LLP only consists of individuals and there are no plans or arrangements to introduce a non-individual as a member.

A relevant tax avoidance arrangement can be any agreement, understanding or any form of arrangement for the loss to be allocated to one or more individuals rather than a non-individual.

The allocation of the losses does not have to be the main purpose of the arrangements, only one of the main purposes.

### 3.4.3. Which losses are affected? (ITA/S116A(6) and S127C(6))

The restriction applies to relief for trade or property business losses and also to claims to use trading losses as relief for capital gains.

### 3.4.4. What is the effect of the restrictions? (ITA/S116A(2) and S127C (2))

Where the restrictions apply, no loss relief is available to the individual for his or her losses from the partnership.

*Example 35:*

*An LLP has 100 individual members and 1 company member. Each of the individual members introduces capital of £40,000 and the company member provides capital of £60m (total capital £100m). The LLP spends the £100m on an asset that qualifies for 100% upfront tax relief generating a £100m tax loss (but not an accounting loss) in the first year of business but with a significant income stream in later years. The profit sharing agreement provides that:*

- *In year 1, all the profits or losses are allocated to the individual members; and*

- *In year 2 onwards, all or most of the profits are allocated to the company member.*

The LLP agreement is written so that the individuals can claim the loss relief.  It is clearly one of the main purposes. The excess loss allocation legislation (S127C) prevents the individual  obtaining relief for these losses.

### 3.4.5. Transitional Provisions

These rules apply for losses made in 2014-15 and later years.

There are transitional provisions that apply if a loss arises in a period of account that begins before 6 April 2014 and ends on or after that date.  In these cases, the loss is to be apportioned on a time basis between the period up to 5 April 2014 and the period from 6 April 2014.

If allocation by time basis produces a result that is unjust or unreasonable, then the loss is to be allocated to the periods on a just and reasonable basis.

The excess loss allocation rules apply to the period from 6 April 2014; they do not apply to the period up to 5 April 2014.

# 4. Alternative Investment Fund Managers: Deferred Remuneration Etc.

## A guide to this chapter



## 4.1. What is this about?

As part of EU-wide strategy for investor protection, AIFM regulations and FCA's rules made pursuant to an EU Directive require AIFM firms to subject part of the "remuneration" of key individuals to performance conditions and to defer when they can access that remuneration.

If an AIFM is a member of a partnership (including an LLP), tax is payable on the profits as they arise rather than when they are received. The AIFMD deferral restricts access to profits of a member of an AIFM partnership, which means that the member is required to pay tax on profits that they do not have access at the time when the tax charge arises under existing partnership tax rules.

The new AIFM provisions will allow the AIFM partnership or its delegate to elect to pay the tax rather than the individual member. The member then gets a tax credit when the remuneration vests but the member will be liable to Class 4 NICs.

This part of the technical note explains how these provisions work. For a summary of the mechanism, see section 4.3 below.

## 4.2. Interpretation

All terms included in interpretation sections (2.2 and 3.2) in the last 2 chapters apply.

“AIF” means an alternative investment fund as defined for the purposes of the AIFMD.

AIFM Regs means the Alternative Investment Fund Managers Regulations 2013 (S.I.2013/1773).

CGT means capital gains tax.

“Deferred remuneration”, “restricted profits” and “variable remuneration” are explained in section 4.9 below

ESMA Guidelines means the Guidelines on Sound Remuneration Policies under the AIFMD issued by the European Securities and Markets Authority on 3 July 2013 (ESMA/2013/232).

FA means Finance Act 2004.

“Instruments” is explained in section 4.13 below.

“Partnership” means any of a General Partnership, Limited Partnership, UK Limited Liability Partnership and any entity formed in a jurisdiction outside the UK that is treated as a partnership for UK tax purposes.

“Partner” includes a member of a Limited Liability Partnership who is not a ‘Salaried Member’.

SPD12 means the Statement of Practice 12 (CG57400)

TCGA means Taxation of Chargeable Gains Act 1992.

TMA means Taxes Management Act 1970.

“Vest” and ”Vesting” are explained in section 4.11 below.

## 4.3. Overview of mechanism

This section gives an overview of how the mechanism works.

The mechanism will be introduced for the 2014/15 tax year. It will permit members of AIFM partnerships or their delegates to allocate certain “restricted” profits to the partnership. These are profits that represent variable remuneration under the AIFMD other than upfront profits that are received in cash.

The legislation will impose a charge to tax on these profits at the additional rate of tax (45%) to be paid by the AIFM partnership.

The balance of the variable profit (i.e. after tax has been paid) will be retained until a particular point (the "vesting date"). If the restricted profits vest in the partner who originally allocated them to the partnership, this individual will be able to claim a tax credit against the tax paid by the partnership upfront. The individual can then set the credit against tax liabilities or obtain a repayment of the tax, depending on his or her circumstances at the time of vesting.

The upfront charge on the partnership applies only to income tax. No NICs charge will arise until the time when the remuneration vests in the individual partner. The treatment of NICs will be covered in separate NICs guidance to be published. Further information about the mechanism may also be published as required.

The key features of the mechanism are set out in section 4.4. below.

## 4.4. Introduction - key features

This section introduces the **key features** of the mechanism as set out below along with links to the key topics for this part of the note:

- any partner in an AIFM partnership can allocate all or part of their ”relevant restricted profit” to the firm which elect to use the mechanism (see sections 4.7-4.8 below). Relevant restricted profit is deferred remuneration (within the meaning of the AIFMD) together with any remuneration which is awarded in the form of instruments that must be retained for at a period of at least 6 months (see sections 4.9, 4.10 & 4.13);

- it will charge tax at the additional rate of income tax (currently, 45%) on that income, with no reliefs or allowances to be available to set against it (see section 4.8);

- where the relevant restricted profit ultimately vests with the partner who initially allocated it to the partnership, this is treated as taxable income of the partner in the relevant tax year. Credit will be available for the tax initially paid by the partnership on the profit, and any overpayment of tax may be repaid (see sections 4.11 and 4.12); and

- for capital gains tax purposes, the partner is treated as receiving any securities at a base cost equivalent to the amount of remuneration they represent, net of tax. The same amount is treated as the disposal consideration (see sections 4.13.3 and 4.13.4).

If the deferred remuneration does not vest in the partner who originally allocated the amount to the firm, the payment will be treated like any other partnership distribution. There will be no further tax liability and no entitlement to recover the tax paid on that element of the deferred remuneration (see section 4.12(c)). A power is provided in the AIFM legislation to make regulations if required.

## 4.5. Who is in the scope of the mechanism?

### 4.5.1. Which partnerships are eligible? (S863D)

The mechanism applies where an election is made by a partnership which is an AIFM firm with an AIFM trade. For election, see section 4.7.

An AIFM firm is defined as a trade which involves, by reference to AIFM Regs:

- wholly or mainly, managing one or more AIFs, or
- wholly or partly, carrying out one or more functions of a person who is managing one or more AIFs as that person's delegate, or as the sub-delegate of a delegate of that person.

### 4.5.2. Which partners are eligible? (S863E)

The mechanism applies, if a partner in an AIFM firm chooses, for any period of account in respect of which a valid election made by the partnership is in force, where the calculation of a partner's profits or losses of the trade produces a profit and the share of profit would, apart from the mechanism, be the relevant restricted profit chargeable to income tax under Chapter 2 of Part 2 of ITTOIA.

If the partnership is an AIFM firm which qualifies for the mechanism because it is a delegate, the mechanism only applies to partners who are 'identified staff' for the purposes of the ESMA Guidelines.

The meaning of "relevant restricted profit" is discussed in section 4.9.

## 4.6. Interaction with excess profit allocation rules (S863F(9))

Any profit reallocated to the individual partner of an AIFM partnership from a corporate partner within the same partnership by virtue of the excess profit allocation rules (S850C) will be eligible to be elect to use the mechanism, if they have profit deferral arrangements in place as a result of the AIFMD.

One of the excess profit allocation rule, S850E permitting certain adjusting payments under the excess profit allocation rules to be made without tax consequences, is ignored for the purposes of this provision (S863F(9)).

## 4.7. Election and profit allocation to the AIFM firm (S863D(2))

An election must be made by the AIFM firm to HMRC within 6 months after the end of the first period of account for which the election is to have effect. It takes the meaning of an election under Schedule 1A of TMA.

Where an election has been made by an AIFM firm, any eligible partner who has relevant restricted profit in that period or any subsequent period may allocate all or any part of that profit to the AIFM firm.

The AIFM firm that elects under section 863D to use the mechanism and prescribed information is required. A partner is not required to make a return of income which is allocated to the partnership until the income vests.

## 4.8. Effect of allocation

### 4.8.1. **Partnership** (S863E)

Where a partner has allocated relevant restricted profit to the partnership, the partnership is liable to account for income tax on that profit (S863E (3)-(4)). The allocated profit is excluded from the partner's profit in that period of account.

For this purpose, the AIFM partnership is treated as if it were itself a person who is a member in the AIFM partnership (including LLP). The usual rules then apply to the AIFM firm, including the self assessment requirements and the obligation to pay tax by instalments (S863E (3)-(4)). The AIFM firm will be required to submit a return on its own behalf for the purposes of the mechanism as well as the partnership returns for self assessment purposes.

Income tax is payable on the full amount of the profit allocated to the AIFM firm without any allowances or reliefs such as personal allowances and relief for losses from prior years (S863E(4)(b)).

The rate of income tax applicable is the additional rate of tax (Section 863E(4)(d)).

### 4.8.2. **Partner** (S863E)

Any deferred remuneration which is relevant restricted profit and is validly allocated to the partnership is excluded from the partner's profit for that period of account and is accordingly not subject to income tax in the partner's hands until it vests (S863E(3)(a)).

A partner will not be subject to income tax on remuneration within the mechanism which does not vest. The tax consequences where remuneration does not vest are set out in section 4.12.

This treatment applies to deferred remuneration in cash or instruments. Upfront remuneration in the form of cash is not eligible for the scheme. Upfront remuneration in the form of instruments with a retention period of at least 6 months is eligible to be included in the scheme (S863E(6)). See section 4.13 below for more information on the treatment of remuneration in the form of instruments.

## 4.9. Relevant restricted profit: Variable remuneration (S863E)

In order for the scheme to apply, the partner's profit share must be relevant restricted profit. This means variable remuneration awarded to the partner (P) can be:

- deferred remuneration (including deferred remuneration which, if it vests in P, will vest in the form of instruments); and

- upfront remuneration which vests in P in the form of instruments with a retention period of at least 6 months.

“Variable remuneration” and “deferred remuneration” have the same meaning as in the ESMA Guidelines (S863E(9)).

It is also a requirement that the variable remuneration is awarded in accordance with arrangements which are consistent with the ESMA guidelines – see section 4.10.

The treatment of deferred remuneration in the form of cash is described in section 4.12. The treatment of deferred remuneration in the form of instruments is described in section 4.13.

## 4.10. Relevant restricted profit: ESMA Guidelines (S863E(7))

It is a requirement for the scheme to apply that the variable remuneration is awarded to the partner in accordance with arrangements which are consistent with the ESMA Guidelines.

**a. The ESMA Guidelines - Definition**

The ESMA Guidelines are defined in S863H as the Guidelines on Sound Remuneration Policies under the AIFMD issued by the European Securities and Markets Authority on 3 July 2013 (ESMA/2013/232).

**b. What the guidelines say**

The ESMA Guidelines broadly require firms managing cumulative assets exceeding certain limits, to defer 40-60% of the variable remuneration of key staff by up to 3-5 years and pay at least 50% of that variable remuneration in units or shares of the funds they manage, or equivalent ownership interests, rather than cash. The application of the rules is subject to a ‘proportionality’ limitation, based on size, internal organisation, and the nature, scope and complexity of activities.

The effect of these Guidelines is that a partner’s remuneration may be in two parts:

- *Upfront element:* this will represent 40% to 60% of the variable remuneration with half taken in cash, which can be drawn immediately, and the half in instruments in the fund under management. The instruments have to be retained for a minimum period (retention period) of six months from the time they are awarded; and

- *Deferred element:* this will represent the balance of the variable remuneration. The deferral required will be 40-60% of the remuneration which must be deferred by up to 3-5 years. Half of the remuneration must be in instruments in the fund. Vesting will normally be pro rata annually. So 40-60% of the year 1 variable profit might not be paid to a partner until years 3 to 5. In some cases, where conditions are not met or the individual has left the firm, the profit may never vest and revert back to the partnership (and therefore to the partners).

**c. Application of ESMA Guidelines**

Not all AIFM firms are required to apply the ESMA Guidelines. For example, small authorised UK AIFMs or small registered UK AIFMs are not required to comply with the AIFM Remuneration Code nor the Guidelines.

A firm that is not required to apply the guidelines may choose to do so as a matter of 'best practice'. Provided that the other conditions are fulfilled, including that the arrangements are consistent with the guidelines, the arrangements may still be eligible for the scheme. In order to be accepted as consistent with the guidelines, the arrangements must incorporate all the relevant provisions of the guidelines as they would do if the guidelines were applicable to the individual concerned.

## 4.11. Vesting: meaning of "vest" (S863F (8))

The period in which a partner pays tax on remuneration to which the mechanism applies depends on when it vests. "Vest" for this purpose has the meaning in the ESMA Guidelines: an amount of remuneration vests when a person receives payment and becomes the legal owner of the remuneration.

## 4.12. Vesting: remuneration in the form of cash

The mechanism applies to variable remuneration awarded to a partner which is deferred. It does not apply to the upfront remuneration element of any profit earned by a partner in the form of cash. This is taxed in accordance with the normal rules.

For the position in relation to variable remuneration in the form of securities, see section 4.13.

In principle, the partner is taxed at the time when the variable remuneration vests, as described below in this paragraph. For the meaning of "vest", see section 4.11. The income is also treated at that time as partnership income for pension purposes. (FA/S189(2B)).

**a. Partner still carrying on the trade** (S863F(2))

Where the partner is still carrying on the trade (whether as a partner in the AIFM firm or otherwise) the amount of variable remuneration which vests is treated as profit of the 'relevant tax year' made by the partner in the trade, chargeable to income tax under Chapter 2 of Part 2 of ITTOIA.

"Relevant tax year" means, in the case of cash, the tax year in which the vesting occurs (S863F(5)).

Reliefs and allowances are available against the profit which vests in the same way as for other trading profit taxable in the same tax year.

The amount treated as profit is the amount received on vesting, grossed up by the income tax payable by the AIFM firm on that amount (S863F(5)). A refund of the tax credit may be available if the partner has unused allowances and reliefs for the year of vesting after they have been applied against other taxable income of that year. If the rate of tax has gone up, further tax will be payable. If the rate has gone down, tax may be repayable (S863F(6)).

**b. Partner no longer carrying on the trade** (S863F(2))

Where variable remuneration vests in a partner at a time when the partner no longer carries on the AIFM trade (whether as a partner in the AIFM firm or otherwise), the amount is treated as income received in the relevant tax year chargeable to income tax under Chapter 18 of Part 2 of ITTOIA.

The relevant tax year and the chargeable amount are determined in the same way as for a partner still carrying on the trade.

**c. What happens if remuneration does not vest?**

Where remuneration in cash covered by the scheme does not in fact vest in the individual, for example because performance targets are not met, the event is disregarded for tax and NICs purposes. Consequently:

- no further income tax is payable beyond the tax already paid or payable by the AIFM firm;
- no one is eligible to claim or recover credit for that tax; and
- no NICs payment will be collected on the profits which do not vest.

## 4.13. Remuneration in the form of instruments

### 4.13.1. AIFMD requirements and definition (S863 (6) & (9))

The ESMA Guidelines require 50% of variable remuneration to be paid in the form of instruments. The tax legislation provides specifically for the treatment of instruments with a retention period of not less than 6 months and those forming part of deferred remuneration (S863E(6)(b)). Other instruments will be taxed in accordance with the usual rules (normally, as profit of the period of account in question).

For the purpose of the scheme, ‘instruments’ has the same meaning as in the ESMA Guidelines (S863E(9)). These define instruments as ‘units or shares of the AIFs managed by the AIFM or equivalent ownership interests (including those AIFs issuing only unit-linked instruments), subject to the legal structure of the AIFs concerned and their rules or instruments of incorporation, or share-linked instruments or equivalent non-cash instruments.’

## 4.13.2. Remuneration in the form of instruments: income tax
(S863E(6))

For the definition of "instruments", see section 4.13.1 above.

The mechanism applies to upfront variable remuneration in the form of instruments with a period of retention of at least 6 months. It also applies to deferred variable remuneration in the form of instruments.

Where a valid election has been made, such remuneration in the form of instruments can be allocated to the partnership and excluded from the partner's return in the same way as with remuneration in the form of cash. See sections 4.7 and 4.8.

A partner will be subject to tax on the remuneration when the right to the instruments vests. The same principles apply as for remuneration in the form of cash. See section 4.12 above.

*Example 36 (Remuneration in the form of cash and instruments):*

**Facts**

TDH LLP is an AIFM firm (S863E), consisting of three members, T, D and H Ltd. The LLP has been trading for many years and draws up accounts to 31 December in each year.

Under the arrangements entered into with TDH LLP, T's remuneration is payable on 1 May 2015, and includes variable remuneration of £1m in respect of his share of the firm's profits for the year ended 31 December 2014 (2014/15 tax year). Of this, £500,000 is paid in cash and the same amount in instruments. 60% of the variable remuneration is deferred. All the instruments have a retention period of at least 6 months. The deferred remuneration is due to vest annually on 1 May in each year up to and including 1 May 2020. For the purposes of this example, it is assumed that the arrangement is consistent with the ESMA Guidelines.

On 1 May 2015, T's non-deferred remuneration is £200,000 in cash and £200,000 allocated in instruments.

Each year of the five year period, therefore, T's entitled to cash of £60,000 and one fifth of the remaining instruments, subject to satisfying the conditions under which the remuneration is awarded.

***A - If no election is made by TDH LLP:***

T is treated for tax purposes as receiving his variable remuneration in full and is taxed on £1m as part of his profit share for the year of account ending on 31 December 2014. This is included in T's assessable income for the tax year 2014/15, with the tax due on 31 January 2016 (subject to the normal payment on account rules). The actual tax liability will depend on T's other income and reliefs.

No further tax is payable by T on the variable remuneration in later years. He is not eligible for any relief if any part of the variable remuneration does not, in fact, vest.

***B - If TDH LLP elects for the mechanism to apply and T allocates all his variable remuneration to the LLP to the maximum extent possible:***

*2014-5*

T can allocate to the LLP his entire entitlement to instruments (upfront and deferred - £500,000 in total) and all the deferred remuneration in the form of cash (£300,000). He can therefore allocate £800,000 to the LLP.

TDH LLP must make a return and pay income tax on the £800,000 for the year 2014/15 as if it was an individual partner in the firm. TDH LLP should also file its partnership tax return separately in accordance with provisions to be introduced in secondary legislation. Assuming that the additional tax rate is 45%, the total tax payable by the LLP will be £360,000, due on 31 January 2016. The LLP will also need to make payments on account for the year 2015/16, of which £180,000 is payable on 31 January 2016 and £180,000 is payable on 31 July 2016.

In order to pay the tax, TDH LLP will only spend the net of tax amount on purchase of instruments. Therefore, assuming it buys all the instruments to fulfil its obligation to T at once, it will spend £275,000 on instruments (and pay £225,000 as tax in relation to them).

T will need to return his non-deferred variable remuneration (£400,000) as a partnership profit share on his 2014/15 tax return. He will remain chargeable to income tax on the amount received in cash (£200,000) for the tax year 2014/15. However, he is entitled to claim a tax credit of £90,000 in respect of the amount to be settled in instruments. This is because the tax has been paid by TDH LLP upon allocation by T of this element of his profits to the firm.

*2015/16 onwards*

In each year that remuneration vests, T receives one fifth of his deferred remuneration (£120,000) net of a tax credit of the corresponding amount accounted for by the LLP (£54,000). Therefore, T will actually receive £33,000 in cash and equities (worth £33,000 when the award was made). The gross amount and the corresponding tax credit should be declared on T's tax return. T will pay more tax, or recover part of the tax credit, depending on his personal tax position and the rates of tax in that year.

The value of instruments on the vesting dates will not be relevant to the income tax calculation.

***C – as in B, but the final instalment of the variable remuneration does not vest in T because he has left the partnership***

In this case, T has no deferred remuneration to report on his tax return. No further tax is payable by him or by TDH LLP in respect of that element of the variable remuneration and none of the tax paid by TDH LLP on that element is repayable.

### 4.13.3. Remuneration in the form of instruments: partner's CGT position (TCGA/S59B and S59C)

A special CGT rule (S59B) is introduced into TCGA to determine the base cost of instruments representing variable remuneration where the mechanism applies. This is as follows:

a) a partner ("P") in a partnership allocates to the partnership an amount of profit ('the allocated profit') representing variable remuneration which, if it vests in P, will vest in the form of instruments;

b) there is a disposal to P by the partners of instruments which are partnership assets of the partnership for the purposes of section 59 of TCGA; and

c) by virtue of that disposal the variable remuneration vests in P.

In this case, the base cost of the instruments to the partner for CGT purposes is the allocated profit net of the income tax which the partnership has paid.

S59C of TCGA has the same effect as a disposal of instruments by a company which is a partner in the partnership and the company would, as another partner, have been charged to tax on the allocated profit but for adjustments under the excess profit allocation provisions (see section 3.3.3 above).

### 4.13.4. Remuneration in the form of instruments: partnership's CGT position (TCGA/S59B and S59C)

The special CGT rule applies to determine the base cost if a partner has allocated variable remuneration represented by instruments to the firm and the variable remuneration vests. Where this rule applies, the disposal by the AIFM firm will be treated as made for a consideration of the same amount as the partner's base cost, and that amount will be the value of the allocated profit net of income tax.

In other cases, the capital gains tax position of AIFM partnerships will follow the general principles set out in SP D12. Assets are treated as being disposed of or acquired by partners for consideration equal to their market value at the time of the allocation. Guidance is included in HMRC's Capital Gains Manual at paragraph CG57400 (SPD12).

Where S59C of TCGA applies (see section 4.13.3 above), there will be a similar effect for the company concerned.

*Example 37 (remuneration in the form of instruments):*

**Facts**

X, P and S are partners in an LLP which is an AIF firm. They share profits in equal shares. In respect of profits for the year ended 31 December 2014, X becomes entitled to variable remuneration of £1m. None of the other partners receives any variable remuneration. The remuneration is all deferred and payable in one instalment on 30 April 2018. 50% of the remuneration is payable in instruments comprising units in a hedge fund. For the purposes of this example, it is assumed that this is consistent with the ESMA Guidelines.

The LLP has elected under section 863D to use the mechanism and X has allocated all her remuneration to the LLP. On 1 May 2015, each unit in the hedge fund is worth £1; on 1 May 2016 it is worth £1.50 and on 30 April 2018, when the remuneration vests, the units are worth £5 each. The LLP buys 275,000 units on 1 May 2016 for £412,500 to hold as partnership assets and transfer to X on the vesting date in satisfaction of her deferred entitlement.

**Income tax treatment**

LLP pays income tax on £1m for the tax year 2014-5 (see example 1 above). Assuming the additional rate of tax is 45%, income tax payable is £450,000 so that a net amount of £275,000 is attributable to the cash and the same amount to the instruments. X's entitlement to instruments is therefore to 275,000 units.

On the vesting date, X is treated as receiving taxable income of £1m, including a tax credit of £450,000.

**Capital gains tax treatment**

The instruments are acquired on 1 May 2016 as assets of the LLP. SPD12 will apply so that each partner is treated as owning a fractional share of the total instruments held, in accordance with the partnership sharing arrangements. Assuming that X and her fellow partners have an equal share in all partnership assets, she is treated as acquiring a one-third share in the instruments on 1 May 2016 as a partner in the firm, while P and S are treated as acquiring the other two one-third shares.

Vesting of the instruments with X on 30 April 2018 represents a disposal by the LLP, which is treated as a disposal by P and S of their shares in the instruments to X. (As X cannot dispose of assets (i.e., her one-third share) to herself, it is only P and S who make disposals for chargeable gains purposes.) The consideration they receive is deemed to be equal to the appropriate share of the net-of-tax profit allocated to the LLP in accordance with section 863E in respect of the deferred remuneration to be settled in instruments (S59B(2)).

P and S each receive consideration of 1/3 x £275,000 = £91,666
Their one-third shares cost 1/3 x £412,500 = £137,500
So each has an allowable loss of £137,500 - £91,666 = £45,834

X's base cost (to be used in computing her gain or loss on any subsequent disposal) is determined by adding amounts equal to the consideration received by P and S to the cost of X's own one-third share: (2 x £91,666) + £91,666 = £275,000 (rounding errors corrected).

If X sells the units shortly after the vesting date (30 April 2018) whilst they are still worth £5 each, she will realise a chargeable gain of:
(£5 x 275,000) – (£320,833) = £1,054,167.

## 4.14. Vesting statements (S863G)

Where variable remuneration vests in a partner, the AIFM firm must provide the partner, if requested in writing, with a statement showing:

- the amount of the allocated profit, or the part of it representing the part of the variable remuneration, gross of the income tax for which the AIFM firm is liable in respect of the allocated profit or the part of it;
- the amount of the income tax for which the AIFM firm is liable; and
- so much of that amount as has been paid by the AIFM firm when the vesting occurs.

The partner can enforce a duty to comply with a request under this section (S863G(3)).

# 5. Transfers of assets and income streams through partnerships

## A guide to this chapter



## 5.1. What is this about?

A number of avoidance schemes have sought to manipulate the flexibility of partnerships to reduce tax by exploiting the differing tax attributes of the members. These 'tax attribute' schemes involve the transfer of assets or income streams through or by partnerships. Generally, some value will pass between the members, reflecting their difference in tax treatment, as part of the arrangements. Draft legislation published with this note will block such schemes.

## 5.2. Interpretation

All terms included in the interpretation sections of the last three chapters apply.

## 5.3. Overview

The legislation is designed to counter 'tax attribute' schemes involving the transfer of assets and income streams through or by partnerships. These schemes do not rely necessarily on the partnership comprising mixed membership, although mixed membership partnerships are within the scope of the rules. The transferor and transferee members may have different tax attributes if, for example:

- the transferee is a company and the transferor is an individual,
- the transferee has losses to use whereas the transferor does not,
- the transferee and transferor are subject to different rate of tax, or

- transferor and transferee are subject to differing tax computational rules in relation to the asset or income.

Where there is a disposal of an asset or income stream through or by a partnership and a main purpose is to secure an income tax or corporation tax advantage, the rules will impose a charge to tax on income on the person making the disposal.

The legislation will not apply where the disposal by or through a partnership is from a member to the member's relative.

## 5.4. When will the legislation apply?

(ITA/S809AAZA & S809DZA for income tax and CTA10/S757A & S779A for corporation tax)

The legislation will apply where:

- a taxable person (the transferor) disposes of, actually or in substance, all or part of an asset or income stream,
- by or though a partnership to another person (the transferee),
- the transferor and transferee are, at any time, members of the relevant partnership or an associated partnership (i.e. a partnership that is a member of the relevant partnership or another associated partnership), and
- the main purpose, or one of the main purposes, of the disposal, or any of the steps by which the disposal is effected, is to secure a tax advantage in relation to the charge to income tax or corporation tax on income.

The legislation does not apply where:

- the transferor is the spouse or civil partner of the transferee and they are living together, or
- the transferor is a sibling, ancestor (e.g. grandparent) or lineal descendant (e.g. grandchild) of the transferee.

## 5.5. What is the effect of the legislation?

(ITA/S809AAZB & S809DZB for income tax and CTA10/S757B & S779B for corporation tax)

When the legislation applies, the "relevant amount" is brought into account as income of the transferor. The relevant amount is the amount of consideration received by the transferor on the disposal. Where an income stream is transferred and the consideration received is substantially less than the market value of the income stream, the market value is used instead

## 5.6. What date does the legislation come into effect?

The legislation will apply to arrangements entered into on or after 6 April 2014 for income tax payers and 1 April 2014 for those within the charge to corporation tax.

## 5.7. Examples

*Example 38 (Transfer of income streams):*

> C Ltd contributes an income producing asset to a partnership. C Ltd would otherwise be chargeable to corporation tax on that income. A new partner, D Ltd, joins the partnership and contributes capital equal to the present value of the income stream. The partnership's profit-sharing arrangement provides that the profits arising from the income stream will be allocated to D Ltd until such time that the value of its contribution has been repaid, along with a lending return. The arrangement allows C Ltd the right to the capital of the partnership, including D Ltd's contribution and the ownership of the underlying asset.

In effect, there has been a sale of an income stream for an upfront lump sum, i.e. D Ltd's capital contribution. Assuming that a main purpose of this arrangement was to obtain a tax advantage, C Ltd will be charged to tax as income on the lump sum payment.

*Example 39 (Transfer of assets**):***

> A company, J Ltd, contributes an asset with an unrealised gain (of a type which if realised would give rise to a charge to tax on income), such as an intangible fixed asset, to a partnership on a tax neutral basis. A new partner, K Ltd, joins the partnership, making a capital contribution equal to the value of the asset. The partnership sharing arrangements are manipulated so that K Ltd had nearly all rights to capital or income until the asset is disposed of, whilst J Ltd has the right to all other partnership assets.

The substance of the arrangements is that there has been a "disguised disposal" of the asset for the amount contributed by K Ltd in order to avoid the tax charge that would have otherwise arisen. The amount of K's contribution will be treated as income of J Ltd.