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 with the exception of one anti-avoidance rule that will have effect when Finance Act 2014 is passed.

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, at the time that the condition is considered, it is reasonable to expect that at least 80% of the total amount payable by the LLP in respect of M’s performance, during the relevant period, of services for the LLP in M’s capacity as a member will be disguised salary. An amount within the total amount is “disguised salary” if it is fixed, or if variable, variable without reference to, or in practice unaffected by, the overall profits or losses of the LLP.

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, at the time the condition is being considered, M's contribution to the LLP is less than 25% of the disguised salary which it is reasonable to expect will be payable by the LLP in respect of M's performance, during the relevant tax year, of services for the LLP in M's capacity as a member.

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 apply to an individual, where they would otherwise apply, if the reason they apply is a consequence of arrangements with a main purpose of circumventing the new profit allocation rules (see Tax Information and Impact Note Partnerships review: partnerships with mixed membership published on 5 December 2013). This exception comes into effect when Finance Act 2014 is passed.

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="5">Exchequer impact (£m)</td><td></td><td>2013 to 2014</td><td>2014 to 2015</td><td>2015 to 2016</td><td>2016 to 2017</td><td>2017 to 2018</td><td>2018 to 2019</td></tr>
<tr><td>Budget</td><td>nil</td><td>+125</td><td>+365</td><td>+300</td><td>+285</td><td>+270</td></tr>
<tr><td>Extra</td><td>nil</td><td>nil</td><td>+680</td><td>+430</td><td>+410</td><td>+400</td></tr>
<tr><td>Total</td><td>nil</td><td>+125</td><td>+1045</td><td>+730</td><td>+695</td><td>+670</td></tr>
<tr><td colspan="7">The first row presents the figures published at Budget 2013 that were set out in Table 2.1 of the Budget Report and certified by the Office for Budget Responsibility (OBR) at that time. More details about the original figures can be found in the policy document published alongside the Budget.

The second row presents the extra costing attributable to the alternative investment fund management (AIFM) sector and has been estimated using information gathered during the consultation carried out over the summer. These figures are set out in Table 2.1 of the Autumn Statement 2013 and have been certified by the OBR. The policy document published alongside the Autumn Statement provides further details.</td></tr>
<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</td></tr>
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	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. 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. There would be some one off costs as professions and taxpayers need to understand the new rules and communicate them to their partnership members. 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. 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. 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 Telephone: 03000 553788 (email: partnership.review@hmrc.gsi.gov.uk).