

Changes to partnership taxation - the next chapter

by David Webster, Russell-Cooke LLP 15 Aug 2013



HMRC's CONSULTATION generated a significant amount of comment, and although relatively little has been heard from the government or HMRC on this issue in recent weeks, it is likely that the spotlight will turn on the proposed changes again in the near future.

The Proposals

The government's intentions in this area were first publicised in December 2012. The Autumn Statement referred to an investigation of the "abusive use of partnerships", and a written ministerial statement also made it clear that the government regarded this as "part of its review of high risk areas of the tax code".

The proposed changes outlined in the HMRC consultation published in May 2013 focus on two main areas:

- Tackling the perceived problem of employees being labelled as LLP members by removing the presumption of self-employment and introducing a new concept of a "salaried member" who will be taxed as an employee regardless of the status given to them within the LLP; and
- Countering the manipulation of profit and loss allocations within LLPs and other partnerships to achieve an "unfair" tax advantage, particularly through the use of "mixed" membership - broadly, the use of corporate members controlled by some or all of the individual members of the partnership.

Scope of the proposed amendments

There is no doubt that there are some aggressive tax planning measures currently being used which seek to take advantage of the flexibility of partnerships, and the different tax rates applying to individuals and companies, and partners and employees - it is easy to see why some of the examples referred to in the consultation document have attracted the government's attention, for example:

- Arrangements where groups of low paid workers who would normally be regarded as employees must accept LLP membership rather than employment status as a condition for work; or
- Structures where a corporate partner is allocated a profit share from a partnership, and those monies are then extracted from the company tax free.

However, it appears as though rather than focussing on those relatively clear cut cases, the government has set its sights on achieving wider change.

It is perhaps understandable that HMRC wants to put LLP members on a broadly equivalent footing to partners in a general partnership and remove the automatic presumption of self-employment. However, depending on the precise drafting of the rules, this could create difficult issues when assessing the status of junior LLP members, particularly in professional practices where it is not unusual for remuneration to be predominantly in the form of a fixed profit share with little practical possibility of any drawings ever having to be repaid.

And while HMRC has confirmed that the new rules on profit allocation are not intended to catch the allocation of profits between family members (of the type considered in Arctic Systems), it has also been quite explicit that it regards certain arrangements which are generally seen as legitimate commercial planning, as likely to be caught by the new rules. For example:

- The retention of profits within a corporate partner for working capital purposes. (According to HMRC, this is an unfair tax deferral.)
- Profit deferral arrangements where a corporate member is used as a means of vesting profits over time for the benefit of individual members.

Next Steps

The government intends to introduce legislation with effect from 6 April 2014, to catch profits and losses arising on or after that date.

We can of course expect a further consultation [exercise](#) well before then, although that is more likely to deal with technical drafting issues than a wider discussion of the scope of the changes. The strong language used when these proposals were formulated indicates that the government is unlikely to be dissuaded easily from pursuing action in this area.

However, the consultation produced a strong reaction from various quarters, including the Law Society. So whilst change in this area is probably inevitable, the government may consider softening the impact of the new rules to deal with business concerns.

All professional practices will need to have this new legislation on their radar, not least because the new rules will not be grandfathered in. Whilst it would probably be sensible to defer drafting possible changes to partnership agreements until the detail of the new rules are clearer, for those businesses falling squarely within the ambit of the proposed new rules internal conversations about restructuring, should happen sooner rather than later.

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