howard hackney LLP

Impact of Autumn statement on partnership structure

15 January 2014

Howard Hackney
Jon Miller – Evolve Legal

Overview

- Draft finance Bill 2014 – may be changed
- Draconian anti avoidance – anything designed to circumvent these new rules
- Fixed share members – Disguised salary
  - Only applies to LLP's
  - Employers NI of 13.8%
  - Treat as employees
  - Always expected a change
- Mixed membership partnerships
  - Not just LLP's
  - Profits "sheltered" in a Ltd Co
  - Profits allocated to family members taxed at lower rates
  - Not expected and arguably unfair to professional firms
- Unlimited partnership normal rules apply
- No silver bullet but a range of solutions

Disguised salary - the three conditions

- Summary
  - Meet at least one
  - Applies only to UK LLP’s
  - A – At least 20% of disguised salary linked to **overall** profits of the firm
  - B – significant say in the management of the business
  - C – capital at risk of at least 25% of disguised salary
- A - Disguised salary
  - Only applies to those working – excludes Ltd Co. or investor
  - Fixed share + bonus not related to overall results = disguised salary
  - <80% fixed of what reasonable to expect (practical likelihood) the total will be – so if expected profits £100k & fixed share £79k – not an employee
  - Link to personal or departmental performance is NOT overall performance of the firm
  - Practical likelihood applies to facts at the time
  - Need for robust & realistic forecasts

Disguised salary - the three conditions

- B - Management
  - To be compliant needs to have significant influence over total business
  - Role not qualification
  - An FD or similar on management committee = compliant
  - Very subjective
- C - Capital at risk
  - Taking real risk
  - >25% of disguised salary - £20k of £80k in above example
  - Remember disguised salary = fixed share plus bonus not related to results
  - Capital excludes tax reserve & undrawn profits
  - But includes loans and undrawn profits allocated to capital
  - Hence importance of formalised agreement on these issues
  - Applies from 5/4/14 – not much time
  - Bank loans to members guaranteed by LLP acceptable
  - BUT NOT non recourse loans

Mixed membership

- Mixed partnerships with non individual members – NOT just LLP's
- Non individuals = Ltd Co, LLP or trust
- If excess profits allocated to non individual
- Catches
  - Profits where a member/partner has widely drawn "power to enjoy"
  - Deferred profits retained in a Ltd Co taxed at 20%
- Ltd co where shareholders not members
  - Does **NOT** apply unless
  - If work carried out by an individual for a partnership or LLP
    - And role looks like that of a member
    - Then treated as a member
- Excess profits
  - After deducting appropriate notional profit
  - Taxed on the member
- Appropriate notional profit
  - Notional return on capital
  - Consideration for services excluding services by partners

Other issues

- Obtaining SRA approval in time
- Will bank be able to react quickly enough?
- Anti avoidance catches anything intended to circumvent
- BUT not avoidance if genuine terms comparable to traditional partnership.
- Use of personal Ltd Co between member & LLP does not work
- LLP gets tax deduction & not incl. on partnership tax return
- If PAYE from 6/4/14 impact on cash flow

Limited company

Limited company benefits

- Seems obvious solution??!!
- Save NI if dividends
- Retained profits (to repay bank or invest) taxed at only 20%
- Potentially shares owned by other family members
- Sale of goodwill still seems possible
  - Best for post 5/4/02 created firms
  - Values subject to challenge
- Sale in market place potentially easier
- Sale by a Ltd Co >10% of shares in a Ltd Co exempt from CGT

Limited company issues

- Compliance cost and complexity
- Lack of flexibility – profit sharing & capital ownership
- Need for retained profits to pay dividends
- Change in shareholding requires share valuation – not necessarily what you agree internally
- CGT potential on market value of any transfer of interest
- Employee related securities
- Profit sharing via remuneration costs NI
- NI saving via dividends with “alphabet” shares
- Differential dividends can be attacked
- Danger of increased tax on dividends – public think higher tax rate is 32.5%
- Costly to disincorporate
- Doing it by 5/4/14
- Impact of dividends on partners income for say mortgage applications

howard hackney LLP

Options

Disguised salary solutions

- LLP profit sharing
  - Revised fixed share based on 80% of realistic expectation
  - BUT partners taking risk & likely to want a quid pro quo
  - Units attract profits with two classes of units
  - At least 2 tranches of profits to protect full equity on upside
  - Careful modelling required
- Break firm down into LLP business units
  - Substantial management influence
  - BUT extent of “Topco” control needs careful consideration
  - Profit linked to overall performance of smaller unit

- LLP capital
  - Link capital to each type of units & hence to profit sharing so normal partnership terms
  - Members to borrow from bank backed by LLP guarantee
  - Interest paid on capital but what about repayments
  - Meet bank soon as will they react quickly enough – by 5/4/14
- Have robust realistic forecasts
- Unlimited partnership?

Mixed partnership solutions

- Objective to retain profits in Limited company for investment
- Full incorporation - BUT
  - Need for retained profits to pay dividends
  - Difficulty in ensuring existence even with commercially justifiable cross charges
  - Lack of flexibility over profit sharing via dividends
  - Need to value shares on each change of capital share
  - Doing it in time
  - Other issues listed above
  - BUT with sale of goodwill for post 6/4/02 firms
- Ltd Co. member where shareholders are not members
  - BUT watch anti avoidance where shareholders involved