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Chartered Accountants

Factsheets

Limited Liability Partnerships

Most important features of LLPs

The key advantage of a LLP compared with a traditional partnership is that the members of the LLP (it is very important that they should not be called partners but members) are able to limit their personal liability if something goes wrong with the business, in much the same way as shareholders in a company have always been able to do. Of course anyone lending money to the LLP such as a bank may still require personal guarantees from the members, as they frequently do with directors/shareholders in a company.

Where business owners have wanted to limit their personal liability in the past, they have normally set up companies and any profits made by those companies are subject to corporation tax. Dividends paid by the companies can then be taken as income of the shareholders. LLPs are taxed quite differently in that the profits are treated as the personal income of the members as if they had run their business as a partnership. The taxation of companies and partnerships is very different but taxation should not be the main consideration in choosing a business vehicle. The Government has introduced new rules which will change the tax status of some LLP members (see Changes ahead for some LLP members). We would be very pleased to discuss the impact of this in any particular case.

LLPs must produce and publish financial accounts with a similar level of detail to a similar sized limited company. In 2016 new legislation has been passed which allows LLPs to qualify as a micro entity which can be used for accounting periods beginning on or after 1 January 2016 with early adoption permissible for accounting periods beginning on or after 1 January 2015. LLPs must submit accounts and an annual return to the Registrar of Companies each year. This publication requirement is far more demanding than the position for non-incorporated partnerships and specific accounting rules may lead to different profits from those of a normal partnership. The filing deadline is nine months after the period end.

Setting up LLPs or converting an existing partnership

A LLP is set up by a legal incorporation process which involves sending certain documents to the Registrar of Companies (more details from Companies House at www.companieshouse.gov.uk) along with the relevant fee. Although it is not legally necessary, every LLP should have a thorough and comprehensive members' agreement in place and needs to have taken legal or professional advice about the issues that should be covered by this agreement. In the absence of a members' agreement the law makes a number of assumptions about the LLP which may not reflect what the individual members intended should there be a dispute.

Existing partnerships can convert to a LLP by exactly the same process of incorporation and providing there are no changes in membership or in the way in which the partnership operates, there may well be no impact on the partnership's tax position. Again care and advice needs to be taken before any decisions are made.

It is not possible for a limited company to convert into a LLP and there will be a significant legal and taxation impact where a LLP takes over the business of a company.

Which businesses might want to use a LLP?

The types of business that LLPs were originally designed for were professional partnerships such as lawyers, surveyors and accountants. In many of these cases, though not all, they have not been able to operate through limited companies because of restrictions from their professional associations and the option of using a LLP offers some advantages.

However other businesses may also benefit from using LLPs, particularly new start-ups who might otherwise have formed limited companies.

What liability might members of a LLP have if something goes wrong?

Because LLPs are relatively new compared to other forms of businesses, there are no decisions yet by the courts where something has gone wrong. This is therefore a hard question to answer but it looks as if the following describes the position as most people understand it at present:

- if, for example, a member of a LLP were to give bad advice to a client and the client suffered a loss as a result, the client may be able to take the LLP to court and be awarded appropriate compensation

- in certain circumstances it could be possible that the member who actually gave the advice may also be required by a court to pay compensation to the client

- it is however probable that any other members who were not directly involved in the advice will not have any personal liability. In a normal partnership it is quite possible that they would have had a personal liability.

It will still be essential for LLPs (and individual members) who might find themselves in this position to have suitable insurance cover.

The other area that needs to be considered is to do with what the law calls unlawful or insolvent trading. In just the same way as company directors can be prosecuted for these offences, members of a LLP can also be prosecuted (and can be disqualified from being a member of a LLP in the future).

A decision to use a LLP?

Increasing numbers of LLPs are being created, despite take up being relatively slow to begin with. Initially many LLPs were start ups but an increasing number of conversions are being made. Any decision to convert an existing partnership or to set up a new business using a LLP is a complex one, involving legal, accounting and tax issues.

Changes for some LLP members

The LLP is a unique entity as it combines limited liability for its members with the tax treatment of a traditional partnership. Individual members have historically been deemed to be self-employed and taxed on their respective profit shares.

With effect from 6 April 2014 the Government considers that deemed self-employed status is not appropriate in some cases. For example, individuals who would normally be regarded as employees in high-salaried professional areas such as the legal and financial services sectors have been benefitting from self-employed status for tax purposes which resulted in a loss of employment taxes payable.

The rules apply when an individual is a member of an LLP and three conditions are met. The conditions are:

- There are arrangements in place under which the individual is to perform services for the LLP, in their capacity as a member, and it would be reasonable to expect that the amounts payable by the LLP in respect of their performance of those services will be wholly, or substantially wholly, disguised salary. An amount is disguised salary if it is fixed or, if is variable, it is varied without reference to the overall profits of the LLP.
- The mutual rights and duties of the members and the LLP and its members do not give the individual significant influence over the affairs of the LLP.
- The individual's contribution to the LLP is less than 25% of the disguised salary. The individual's contribution is defined (broadly) as the amount of capital which they contributed to the LLP.

These rules took effect from 6 April 2014.

How we can help

We would be delighted to discuss these issues with you and demonstrate what the impact on your business would be. Please contact us for further information.

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