LF LUBBOCK FINE



LIMITED LIABILITY PARTNERSHIPS

FACTSHEET

LIMITED LIABILITY PARTNERSHIPS

MOST IMPORTANT FEATURES OF LLPS

The key advantage of an 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. However, some LLP members can be taxed as if they are employees in certain circumstances (see Tax treatment for certain LLP members, below). 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. 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. Companies House provides a useful guide to the requirements in respect of LLP accounts.

SETTING UP LLPS OR CONVERTING AN EXISTING PARTNERSHIP

an LLP is set up by a legal incorporation process which involves sending certain documents to the Registrar of Companies 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 an LLP by the 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 an LLP and there will be a significant legal and taxation impact where an LLP takes over the business of a company.

Companies House provides a useful guide to the legislation and background to Limited Liability Partnerships.

WHICH BUSINESSES MIGHT WANT TO USE AN 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 had historically not been able to operate through limited companies because of restrictions from their professional associations and the option of using an 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 AN 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 an 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 an LLP can also be prosecuted (and can be disqualified from being a member of an LLP in the future).

A DECISION TO USE AN LLP?

Any decision to convert an existing partnership or to set up a new business using an LLP is a complex one, involving legal, accounting and tax issues.

TAX TREATMENT FOR CERTAIN 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 can be deemed to be self-employed and taxed on their respective profit shares.

However, deemed self-employed status is not automatic for all members. For example, individuals who would normally be regarded as employees in high-salaried professional areas such as the legal and financial services sectors originally benefited from self-employed status for tax purposes which resulted in a loss of employment taxes payable. As a result, the tax treatment of certain LLP members was changed so that their taxes are paid under PAYE.

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 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.

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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