

LLP salaried partners update (Lecture B1457 – 8.03 minutes)

The salaried members rules were introduced in FA 2014 to determine whether LLP members should be taxed as self-employed or employed.

The rules

The rules set out three conditions, and where all three conditions are met, the LLP member will be treated as an employee for tax purposes.

Condition A: Disguised salary

Condition A will be met if it is reasonable to expect that at least 80% of the total amount payable by the LLP in respect of the member's performance during the relevant period of services for the LLP will be 'disguised salary' (ITTOIA 2005 s863B), i.e. does not vary with the profits of the LLP as a whole.

Condition B: Significant influence

Condition B will be met if the member does not have significant influence over the affairs of the LLP under the mutual rights and duties of the members of the LLP, and of the LLP and its members (ITTOIA 2005 s863C).

Condition C: Capital contribution

Condition C will be met if the member's capital contribution to the LLP is less than 25% of their disguised salary from the LLP in the relevant tax year (ITTOIA 2005 s863D).

The TAAR

The salaried members rules include a targeted anti-avoidance rule (TAAR) which disregards arrangements with a main purpose of securing that one or more members are not deemed to be salaried members (ITTOIA 2005 s863G).

Existing practice

To ensure that members were treated as self-employed rather than employed, it has been common practice for LLP members to have a capital account of at least equal to 25% of any 'disguised salary'. Provided that this capital was genuinely at risk within the LLP, it was understood that it would not fall foul of the anti-avoidance provision.

HMRC's updated guidance

In February 2024, HMRC included a new example in its Partnership Manual at PM259200 regarding condition C and when the TAAR will apply which reads as follows:

In 2018, upon joining the ABC LLP, member X contributed capital of £15,000 (this was not part of any arrangement with a main purpose of securing the salaried members rules do not apply and is a genuine contribution).

In 2022 it is expected that X's remuneration for the next period will consist of £100,000 Disguised Salary, meaning that their contributed capital is below the 25% threshold, and they will meet Condition C.

X contributes a further £10,000 as part of a separate arrangement with the LLP, where members increase their capital contribution periodically in response to their expected disguised salary, in order to avoid meeting Condition C.

HMRC state that this arrangement will trigger the TAAR and no regard can be given to the £10,000 when considering whether X meets Condition C.

As such X will meet Condition C as their contributed capital remains at only £15,000.

The Chartered Institute of Tax's concern

The Chartered Institute of Tax (CIOT) disagree with HMRC and has written to them explaining their concerns about the new guidance. The CIOT believes it is contrary to the policy intent behind the TAAR which was designed 'to counter abusive arrangements' that 'have no other substantive effect'.

The CIOT stated that:

'We find it difficult to see how the making of a genuine capital contribution can be regarded as being abusive or has having no other substantive effect'.

HMRC's own guidance confirmed that no restriction was placed on the ability to make or increase capital contributions to comply with the Condition C requirement and fall outside of the salaried member rules.

The Institute believes that if 'sufficient capital is genuinely contributed by a member and gave rise to real risk, i.e. there were no artificial arrangements used to negate this risk, such as a non-recourse loan, then the TAAR would not apply and the member would not meet Condition C.'

The CIOT also states this is a new stance being taken by HMRC who state:

'it is the experience of CIOT members that HMRC have historically agreed that LLPs and their members can achieve certainty in respect of the salaried members rules by complying with the requirements of Condition C and, in some cases, HMRC have even provided assurance that Condition C is not met so long as the requisite amount of capital has genuinely been contributed'.

The CIOT are aware that HMRC are seeking to assess liabilities going back up to six years based on the change of view.

CIOT summary

The CIOT consider HMRC's new approach goes against the legislation.

Further, it is unfair as it penalises LLPs and their members who have to date complied with the rules to the best of their knowledge, based on statements and guidance published by HMRC as well as direct discussions with HMRC officers.

he CIOT believe that HMRC should:

- remove the updates to the guidance made in February 2024;
- cease its compliance activity based on the revised practice.

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