



Transparency and Trust

ICAEW welcomes the opportunity to comment on *The Government Response to the Transparency and Trust consultation of July 2013* published in April 2014, a copy of which is available from this [link](#).

This ICAEW response of 30 June 2014 reflects consultation with Business Law Committee which includes representatives from public practice and the business community and is responsible for ICAEW policy on business law issues and related submissions to legislators, regulators and other external bodies. It also reflects comments from ICAEW's Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world.

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Comments on Government proposals to prohibit corporate members of LLPs

Introduction

1. We refer to proposals made in the Government Response of April 2014 to the transparency and trust consultation of July 2013, which can be found at this [link](#) ('Government Proposals').
2. Comments were invited on a number of areas of the Government Proposals, but the Small Business, Enterprise and Employment Bill has since been introduced into Parliament (on 25 June 2014). We will be commenting on various aspects of the Bill as it passes through the Parliamentary process.
3. However, we understand that Department for Business, Innovation and Skills ('BIS') is still seeking views in relation Government Proposals for restricting the use of corporate members of LLPs and we are therefore responding separately on that issue in this response.
4. As we have outlined in correspondence with BIS, we do not believe that LLPs should be subject to any prohibition on corporate members. We are writing to explain our position more fully in this response.

Clarification of the nature of the possible additional regulations

5. Paragraph 169 of the Government Proposals seeks views on whether or not LLPs should be included in the proposed new system prohibiting companies from having corporate directors; the Government sees a 'case for consistency' for inclusion.
6. Paragraph 169 could be interpreted to mean either that LLPs would be prohibited from having corporate directors (as is proposed for companies) or that the prohibition on companies having corporate directors would be extended to having LLPs as directors. We understand from our conversations with BIS, that it is only the former alternative that is under consideration and it is, therefore, only that on which we comment.

Proposal would ban corporate membership of LLPs

7. While 'consistency' is given as the rationale for the proposal, it would not result in consistency at all, because, unlike companies, LLPs do not have directors (the members themselves being responsible for managing the LLP): the fundamental point about an LLP is that, unlike a company, it effects no separation between membership and being an agent of the entity (s6 LLP Act 2000). The proposal would have the effect of prohibiting members from being companies, which is a very different thing (the equivalent being to prohibit corporate ownership of shares in limited liability companies, which is not something that is being, or should be, contemplated). No case has been put forward for such a change; we do not believe that a case exists.
8. Although LLPs are required to have designated members, these have certain specific functions, largely of an administrative nature, and a designated member function is more akin to that of a company secretary than a director of a limited liability company. There is no requirement for any of the members of an LLP to be natural persons (in contrast to the position for directors of companies).

Background to LLP form

9. LLPs are a flexible and competitive commercial structure. They were introduced in 2000 to provide an alternative business structure to the long established forms of company or general partnership and the number of them has grown considerably since then.
10. The tax rules for LLPs follow those for ordinary partnerships and all partnerships are treated in the same way no matter how many partners are in the partnership. Historically there were some limits on the number of partners that could form a partnership, although many types of professional partnerships were exempted from this requirement. In 2002 the upper limit was abolished entirely. While the vast majority of partnerships in the UK have only two or three partners, we note that some (usually professional) partnerships, particularly LLPs, are considerably larger and find this form particularly suitable for their business requirements.
11. In short, this is a significant form of business in the UK contributing to the wider UK economy. As we shall see below, corporate members are used frequently and for diverse legitimate business reasons. Additional regulation designed to restrict this use will affect the attractiveness of the form and impede UK business choice.

LLPs and tax

12. Some important tax reliefs and credits for businesses are made available only to companies, for example, research and development tax credits and the patent box regime. An LLP can only benefit from these through having corporate members.
13. A partnership is transparent for tax purposes, unlike income tax which is aimed at individuals or corporation tax aimed at companies. Consequently, although a partnership submits a tax return each year, any profits are allocated to the partners and taxed on them, with individual partners paying income tax in respect of any allocated share of partnership profits through their own personal tax returns. Corporate partners will pay corporation tax on shares allocated to them.
14. Whether or not funds have been withdrawn from the business, each partner must pay their own individual tax liability. If the LLP needs to retain funds for working capital, it can therefore be more efficient for these funds to be those representing a corporate member's interest in the business. We illustrate this using an example, see example 4 in the Appendix .
15. These are non-exhaustive examples of uncontentious tax related reasons why a business may be structured as an LLP with corporate members. As with any form of business, there can be cases where the form is used for reasons that, as public policy changes, are ultimately considered to be no longer suitable. We believe that these concerns should be addressed through appropriate changes, for example, to the tax regime, not through a general ban on corporate memberships of LLPs. We note, in that context, that the Finance Bill 2014 has made significant changes to the tax treatment of corporate members in LLPs.

Timing of the BIS proposal

16. The process which has led to the tax changes brought by Schedule 13, Finance Bill 2014, has been protracted, causing major disruption and uncertainty to partnerships including LLPs over an 18 month period. Many of the affected businesses (including SMEs) have decided to restructure their business to reflect the new rules, at considerable cost. It would be inconsistent with the government's publicly declared aim

of cutting red tape, now to introduce further changes in related areas leading to additional costs and distractions to UK business. The current uncertainty is itself distracting and damaging and we urge Government not only to conclude that these latest proposals should not be pursued, but to do so as soon as possible and make a public statement to that effect.

Other business related reasons for using a corporate member of an LLP

17. As noted above, there are a variety of reasons why a business may choose to use a combination of the LLP and corporate membership for legitimate tax related reasons. Given that there are different tax regimes applying to different forms of business, this enables business to operate as efficiently as possible.
18. There are other reasons for use of corporate members.
 - An LLP may need external capital to fund business expansion and the capital provider will often be a company.
 - It may be used as a vehicle for joint venture businesses between companies or between companies and individuals (including, for instance, in the property sector).
 - Business may wish to convert from a company to an LLP and corporate membership enables this to occur without a taxable disposal. Similarly, a business may wish to convert from an LLP to a company, and this can be facilitated cost effectively through corporate membership.
 - A sole owner of an unincorporated business does not benefit from limited liability protection. The business may not wish to incorporate, but instead it could use the LLP form provided a second partner can be found; an LLP requires at least two members, as did private companies limited by shares, until relatively recently. The use of a corporate member enables the form to be used by one active member.
 - A corporate member can be used as the third member of a two person partnership to prevent de facto cessation of two member LLPs if one member dies.
19. We have received many examples of use from our members, a small selection of which are given in examples 1-3 in the Appendix for illustrative purposes.
20. This does not purport to be a comprehensive summary of the various ways that corporate members may be useful in the context of LLPs, but is intended to demonstrate that use is sufficiently varied that a prohibition will cause widespread disruption to business using the LLP form.

Conclusion

21. The proposal would have the effect of banning corporate membership of LLPs, akin to banning corporate membership of companies. Given the widespread and varied use of corporate members in the LLP form, we believe that such a ban would require much more compelling, evidence-based reasons than 'consistency' with the different position of a company's directors. We are not aware of any such reasons. So far as 'transparency' itself is concerned, the transparency rules to be introduced for corporate members would apply.
22. If the Government were to pursue this further, we trust that there would be further consultation and would request that we be fully included in that.

APPENDIX

Examples

Example 1

“My own firm used to be an LLP, initially comprising me and my partner..... does the back office assistance, including occasional debt chasing, ...form-filling etc. We added a limited company as a partner in case anything happened to [my partner] - if I die the practice will end; if he died, or became ill, or simply wanted to retire, without a second partner, we would lose our limited liability after 6 months: so we had a very genuine reason for putting the corporate partner in place...I know other firms with two individual partners who have kept their corporate partner (now not receiving any profit share) for precisely the same reason: to give them a "spare" and ensure limited liability protection is maintained in the event of something happening to one of the other two partners. Other LLPs are structured from the start with just one individual partner as Mr X and X Limited to give them the necessary minimum two partners.”

Example 2

“..companies will often want to come together in joint ventures of one sort or another. Our clients frequently do it, especially in the property sector. If they are prevented from doing so via LLPs they will have to use either jointly-owned companies or general partnerships. But the first does not have the flexibility of an LLP, particularly as regards sharing of profits; and the second risks exposing assets of the co-venturers to unlimited liability, such that in practice each partner would inevitably form an SPV for the purpose. Forcing corporate joint ventures either into the inflexibility of jointly-owned companies or the complexity of an additional level of ownership structure runs counter to Government's aims of promoting simplicity and removal of barriers. And, importantly, in neither case does it add anything to the openness or transparency which is said to be the driver behind this proposal.”

Example 3

“To assist the ICAEW with its response we have set out one such example of a legal firm, let's call it A Ltd. A Ltd has entered into two separate joint ventures with two other legal firms. Let's call them B Legal Ltd and C Legal Ltd. A Legal Ltd wants to make the most from a certain area of law that has been subject to a lot of changes recently, as do B and C Legal Ltd. A's business acumen and contacts can help B and C and visa versa. It is also worth noting that A, B and C Legal Ltd all want to keep their new ventures separate from their existing businesses for obvious reasons, hence the joint ventures. Let's call the two joint ventures JV1 LLP and JV2 LLP.

The operation of each JV LLP is determined purely on commercially agreed terms, governed by LLP agreements. Therefore all profits of each JV LLP will be shared in accordance with those terms. It is still more common for law firms to operate through partnerships or LLPs because of the flexibility of such a structure, as opposed to companies (because it is difficult to embody the complexities of partnership agreements into a shareholders agreements in a satisfactory way), hence the JVs being LLPs.

If it becomes no longer possible for a company to be a member of an LLP, then A, B and C will all have to take independent professional advice in order to restructure their joint ventures in such a way as to retain their agreed terms while complying with the new rules.

The advice will also have to take into the account the potential tax implications of a restructure. After taking professional advice, implementation will have to follow, taking further time and costing more money, in part dealing with the necessary administration relevant to their professional bodies. Overall, this will have a significant cost both in terms of money and time for each business, and will slow or impede each JV's offering to the market. It is also likely that such extra time and cost would stifle this expansion of their respective businesses and may lead to JVs not proceeding.

This is just one example of why a proposal to ban corporate members of an LLP would have an adverse effect on businesses and the economy.

As a final point the Government has legislated to introduce non-lawyer owners of law firms and now, strangely, seems to be taking away a viable commercial structure which would use this new legislation. Commercial joint ventures are also an obvious way for one-stop-shop rounded professional advice that the Government has indicated should be possible following the Legal Services Act. Why would they now remove that option?"

Example 4 (illustrative of a long standing practice of which HMRC is aware)

This illustrates how a corporate member of an LLP can assist a business to retain funds to finance the business' working capital needs.

Angie, Betty, Cathy and Daisy Ltd are partners in Tripod LLP. Angie, Betty and Cathy own all the shares in Daisy Ltd. All profits are shared equally each year.

In the year ended 31 March 2014, Tripod LLP made a profit of £400,000. This is all shown as cash in the business' balance sheet.

The four partners will each be credited with £100,000 through their partner current accounts. Angie, Betty and Cathy will each have to pay income tax and National Insurance on this personally. Because they are paying tax on their shares, they want to receive this as cash and so each withdraws £100,000 cash from the business, leaving £100,000 in the bank. Daisy Ltd's share has been retained in the business.

When Daisy Ltd's corporation tax becomes due on its £100,000 taxable profit, Daisy Ltd will decide to withdraw £20,000 so that it can pay its tax liability, but the remaining £80,000 can be left within the partnership's bank account to finance the business' working capital needs.

Without Daisy Ltd, then Angie, Betty and Cathy would be taxed as if they had withdrawn all profits notwithstanding that they have re-invested some of that in the business.