

TAXREP 30/99

LIMITED LIABILITY PARTNERSHIPS

The comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales on the DTI consultation document entitled 'Draft Regulations' published in July 1999

CONTENTS	Paragraph
Background	1 - 4
The Revised Draft Bill	5 – 9
Remaining areas which require clarification	10 – 12
Other areas	13 – 17
Overseas LLPs	18 – 19
Conclusions	20 – 21

LIMITED LIABILITY PARTNERSHIPS

BACKGROUND

1. The Tax Faculty commented on the earlier Government observations on the fourth report from the Trade and Industry Committee (Session 1998 – 99) on the draft Limited Liability Partnership Bill. These comments were published as TAXREP 18/99. The Government observations on UK taxation matters were set out in paragraphs 79 to 85. Observations of the tax treatment of overseas LLPs were set out in paragraphs 86 to 91.
2. We noted and agreed with the concerns expressed by the Committee on the importance of full consultation on any draft secondary legislation. At the time of our earlier comments, we were unsure as to whether the draft secondary legislation would include taxation provisions.
3. The Department of Trade and Industry ('DTI') published in July 1999 a revised Draft Bill together with the proposed Regulations. The DTI is not seeking further comments on the Draft Bill but is inviting further comments on the Draft Regulations.
4. The Draft Bill includes revised clauses in respect of taxation. There are no taxation provisions in the Draft Regulations and it is now clear that no secondary legislation for tax purposes is considered to be necessary.

THE REVISED DRAFT BILL

5. As mentioned above, the DTI is not seeking further comments on the Draft Bill. Nevertheless, we made a number of important points in our earlier comments and we think it is important to ensure that our earlier comments have been addressed. If formal consultation on these matters with the DTI is now closed, then we will need to raise them again with the relevant departments as part of our normal representation process.
6. We have therefore reviewed the earlier comments that we made on the Draft Bill, together with the Government observations on how it proposed to deal with the questions raised by the Committee. Our comments are set out below.
7. **Taxation neutrality**

In paragraph 3 of TAXREP 18/99, we said:

We welcome the fact that the Limited Liability Partnership Bill ('LLP Bill') (rather than any delegated legislation) will include references to the tax provisions as set out in paragraph 80 of the observations. However, it is not clear whether, for example, the specific problems outlined in paragraph 79 will be included in the Bill or instead will be set out in delegated legislation.'

8. Clause 10 of the Draft Bill inserts new sections into the Income and Corporation Taxes Act 1988 ('ICTA'), the Taxation of Chargeable Gains Act 1992 and the Inheritance Act 1984. The key provision is the proposed insertion of a new section 111A into ICTA. This provides that for all purposes of the Tax Acts, a trade, profession or vocation carried on by an LLP shall be treated as carried on in partnership by its members. The result of this provision appears to deal satisfactorily

with the specific problems identified in paragraph 79, because if the LLP is treated as a partnership for all purposes then the existing tax rules that apply to partnerships will apply automatically to LLPs.

9. Thus, for example, if a partnership wishes to convert to an LLP, then this will be treated as a transfer of a business between two partnerships. Provided that the necessary conditions are met, this will be treated for tax purposes as a 'continuation' of the old partnership and not as the discontinuance of the old partnership and the commencement of a new LLP. Thus, it appears that the 'incorporation' of an existing partnership as an LLP will be 'tax neutral'.
10. One issue which we did not raise in our earlier note was the availability of interest relief. Section 362(2)(a), ICTA 1988 denies relief for interest paid by a limited partner. We think this provision should be disappplied, so that members who borrow to provide capital to an LLP should be entitled to interest relief.

Remaining areas which require clarification

11. In our earlier comments, we set out various matters that we believe still needed to be clarified, as follows:

Loss relief (Paragraph 7)

We note the statement in paragraph 79 that the members of a LLP will be entitled to the same tax reliefs as partners but would welcome confirmation that the loss relief provisions will apply to LLPs, subject we presume to the limitation on loss relief for limited partners. The latter provisions are set out in section 117, Income and Corporation Taxes Act 1988 for individuals and section 118 for companies and we presume that these provisions will need to be amended to include partnerships registered under the LLP Bill.

12. The Government has made no further comments. We believe that the comments made above will apply as a result of the proposed new section 111A ICTA 1988, but will write to the Revenue to confirm this.

VAT (Paragraph 8)

There are no references to the VAT position of a LLP. The VAT rules contain specific provisions to deal with partnerships. We think it is important that LLPs are treated as partnerships for VAT purposes, and therefore the VAT provisions dealing with partnerships will need to be extended.

13. We are slightly surprised that it was not felt necessary to amend the Value Added Tax Act 1984 along the lines mentioned above. We intend to write to Customs and Excise to seek confirmation of their understanding of how an LLP will be treated for VAT, and if necessary pressing for an amendment to be made in the annual Finance Act.

Other areas

14. In our earlier comments we also raised a number of other points in relation to stamp duty and also Inland Revenue Statements of Practice. We have set below our earlier comments in *italics*.
Stamp duty (Paragraph 9)

‘We welcome the proposed relief from stamp duty set out in paragraph 83 but we are concerned that the conditions attached to the proposed relief are too restrictive. Stamp duty is becoming a significant burden on business transactions and we are concerned that it does not inhibit, for example, a move to a LLP where the majority of partners are the same before as after. We suggest that the condition that all the partners be the same before as after should be relaxed to one where at least 75% of the partners are the same before and after, thus mirroring the equivalent stamp duty reliefs for transactions within a group.

15. The stamp duty provision in the Draft Bill does not include any relief along the lines proposed above. We intend to consider this point further and if necessary make representations as part of our exercise dealing with Budget submissions and anomalies.

Statements of Practice (Paragraph 10)

‘We note the Inland Revenue’s intention to apply various Statements of Practice etc which are listed in paragraph 85. We would point out that ESC A37 - Directors fees received by a partnership - is currently subject to change on the basis of the proposal to introduce rules to counter the use of personal service companies. The proposals appear to suggest that this concession will in effect be withdrawn. It is our view that any new rules introduced in this area should not apply to the situation as set out in the concession, and we are currently in consultation with the Revenue to limit the impact of this proposal. We think that the time has come to give legislative backing to the concession, thus putting beyond doubt the position that partnerships (including LLPs) are able to receive directorship fees gross. ‘

16. We are still in discussion with the Revenue in relation to personal service companies. In relation to the proposed legislating for ESC A37, we again intend to make further representations as part of our exercise dealing with Budget submissions and anomalies.

OVERSEAS LLPs

17. The Draft Bill includes provisions in relation to Overseas LLPs. The provisions empower the Secretary of State to make future Regulations in respect of the winding up of Overseas LLPs, although no such Regulations are planned at present. It does not appear that any special Regulations will be introduced to deal with the taxation position of LLPs.

We said in our earlier representation (paragraphs 11 to 16)

Paragraph 11

We note the comments made by the Revenue as set out in paragraph 90 concerning the method whereby they classify foreign entities (and in particular overseas LLPs) for the purposes of UK taxation. These comments appear merely to set out the current published position of the Revenue and do not appear to reflect adequately the proposed introduction into the UK of limited liability partnerships.

Paragraph 12

We are concerned that the existing classification of foreign LLPs is not always consistent. For example, in a recent High Court case, the Revenue refused to confirm that a Jersey registered limited partnership would be treated as a partnership for UK tax purposes rather than a body corporate. However, we understand that certain US LLPs that operate in the UK through branches are treated as partnerships.

Paragraph 13

If LLPs are introduced into UK law, we suspect that all of the existing decisions made by the Revenue on the classification of foreign entities that may have the characteristics of limited partnerships will need to be reviewed. In view of the recent High Court decision mentioned above, it would be helpful if the Inland Revenue issued a statement as to whether their view of the characterisation of a Jersey limited partnership for UK tax purposes will change if the UK introduces LLPs.

Paragraph 14

We note that the Revenue have said that they will publish in a forthcoming issue of Tax Bulletin a list of their decisions on the UK tax treatment of foreign entities and their tax treatment. However, the list has yet to appear. We think that the list should be published as soon as possible. The list should also include a note for each entity as to whether the Revenue believe that their existing decisions may need to be revised to take account of UK LLPs.

Paragraph 15

The proposed introduction of UK LLPs provides an opportunity to ensure that the treatment of overseas LLPs for UK tax purposes is consistent. We think it will make sense (assuming that UK LLPs become UK law) to treat all overseas LLPs as UK LLPs for the purposes of UK taxation. This may require existing entities to be reclassified as a limited partnership.

Paragraph 16

In the event that the tax status of an overseas entity needs to be revised, we are concerned that the entity is not disadvantaged and that there are no unexpected charges to UK taxation. This may require legislation, possibly supplemented by an extra statutory concession and a statement of practice.

18. The proposed list mentioned in paragraph 14 has still not appeared in Tax Bulletin. In addition, none of the other points which we raised appear to have been addressed. It is important that they are, and we intend to take up these issues with the Revenue as part of our review of Budget submissions and anomalies.

CONCLUSIONS

19. The major concerns in relation to the taxation neutrality of LLPs appears to have been addressed.
20. We are not convinced that all of the possible problems have been addressed, and believe that the revenue departments should meet with the representative bodies to identify any areas where taxation neutrality may not be achieved and how these may be remedied.
21. The taxation position of overseas LLPs has still not been resolved in a satisfactory way. We intend to take up our concerns with the Inland Revenue.

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