

LIMITED LIABILITY PARTNERSHIPS ACT 2000

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Taxation

Section 10: Income tax and chargeable gains

This section ensures that the members of an LLP which is carrying on a business with a view to profit are treated for the purposes of income tax and capital gains tax as if they were partners carrying on a business in partnership, despite the fact that section 1(2) of the Act establishes an LLP as a body corporate.

In *subsection (1)* the new section 118ZA of the Income and Corporation Taxes Act 1988 (ICTA) provides that, for the purposes of the Acts relating to income tax and corporation tax, a trade, profession or business carried on with a view to profit by an LLP shall be treated as carried on by the members of the LLP as partners carrying on a trade profession or business in partnership. It also provides that the property of the LLP shall be treated for those purposes as partnership property. This ensures that, like partners, the members will be individually liable to tax on their shares of the profits of the trade, profession or business carried on by the LLP.

The new section 118ZB ICTA operates to extend the provisions of sections 117 and 118 ICTA to members of LLPs that carry on a trade. The new section 118ZC will establish the limit on the tax relief for interest and trading losses that members of an LLP can claim against income other than from the LLP. The limit for relief claimed by members of LLPs would be the amount they have subscribed to the LLP together with any further amount that they have undertaken to contribute in the event that the LLP is wound up. Subject to the further provisions of the new section 118ZC(3) the amount subscribed will normally be the amount of the partner's investment in a conventional partnership that becomes an LLP or the amount that he has invested in the LLP when he became a member or founded the LLP. The further provisions set out in this new provision ensure that the capital invested remains in the LLP and that there are no other arrangements for extracting value from the LLP in some other way. For example, there is a requirement that the investment in the LLP must endure for a given period so that members cannot make capital contributions to give them access to the tax relief and then, after having the relief, withdraw them.

The restriction on tax relief that is imposed by sections 117 and 118 of ICTA is only against tax relief for interest and trading losses set against the members' income other than that which they earn from the LLP. There will be no restriction on any relief set against LLP income. This means that any balance of loss relief after the restriction is applied can be carried forward and set against members' future shares of their LLP profits.

The new section 118ZD is designed to ensure that tax relief can be obtained where a member of an LLP who has had relief restricted to their capital contribution makes a further capital contribution in a later chargeable period.

Subsection (3) inserts new section 59A in the Taxation of Chargeable Gains Act 1992 (TCGA). New section 59A(1) provides that the assets of the LLP shall be treated as assets held by the members as partners for the purpose of taxing chargeable gains. This ensures that the members of the LLP, rather than the LLP itself, will be liable to tax for chargeable gains on the disposal of LLP assets. The section brings LLPs in line with the approach adopted for partnerships in section 59 TCGA, which similarly treats assets as held by the partners rather than by the partnership entity.

The new section 59A(2) sets out how the chargeable gains of an LLP will be taxed when section 59A(1) ceases to apply (usually, when the LLP goes into liquidation). This provides that the LLP (through its liquidator) will be taxed on disposals of assets under the normal corporate insolvency rules. Chargeable gains on assets disposed of in the liquidation period will be taxed as if the section 59A(1) partnership tax treatment had never applied and the only capital asset which the members will then hold for tax purposes will be their interest in the LLP. The proceeds of disposal of members' interests will be based on the amount of the liquidator's capital distributions (if any) to the members, after he has met the claims of the creditors of the LLP. And in calculating the chargeable gain or allowable loss on that disposal, each member's interest will be taken as acquired on the date they originally joined the LLP and by reference to their capital cost of becoming a member.

Subsection (4) inserts new section 156A TCGA. This ensures that any gain on an LLP asset which a member has postponed as a result of claiming business asset roll-over relief (under sections 152 to 154 TCGA), and which has not subsequently come back into charge on disposal of the replacement asset prior to liquidation of the LLP, will be taxed on the member when that liquidation occurs. This section is required to prevent deferred gains from falling out of charge when members cease to be taxed as partners on the disposal of LLP assets. The reasons why such gains would otherwise fail to be taxed are, firstly that there is no general occasion of charge on members when the LLP's assets vest in a liquidator and, secondly, because a member's previous roll-over relief claim cannot be taken into account where the replacement asset is disposed of by, and taxed on, an LLP (through its liquidator) as a separate taxable entity.

Section 11: Inheritance tax

This section inserts a new section in the Inheritance Tax Act 1984. This provides that for inheritance tax purposes the members of an LLP are treated as if they were partners in a partnership. This ensures that inheritance tax will be charged in respect of members' interests in an LLP as it is in respect of partners' interests in a partnership, and that business relief will be available on the same basis.

Section 12: Stamp duty

Subsection (1) provides for relief from stamp duty on an instrument transferring property from a person to a newly incorporated LLP in connection with its incorporation, subject to a time limit of one year from incorporation and to the conditions in subsections (2) and (3).

Subsection (2) The first condition is that at the relevant time the person is *either* a partner in a partnership of the persons who are or are to be members of the limited liability partnership, *or* holds the property as nominee or bare trustee for one or more of the partners.

Subsection (3) The second condition is that *either* the proportions of the property transferred to which the persons referred to in subsection (2)(a) are entitled immediately after the transfer are the same as at the relevant time, *or* none of the differences in those proportions is attributable to tax avoidance.

Subsection (4) sets out the circumstances in which a person holds property as bare trustee for the purpose of subsection (2).

These notes refer to the Limited Liability Partnerships Act 2000 (c.12) which received Royal Assent on 20 July 2000

Subsection (5) defines “relevant time” for the purpose of the section.

Subsection (6) provides the administrative procedure for relief under the section.

Section 13: Class 4 national insurance contributions

This section ensures that Class 4 national insurance contributions, which are chargeable on partners’ shares of partnership profit, are chargeable in the same way on members of LLPs.