

Limited Liability Partnerships



► **Inside**

Key features
Incorporation and administration
Members' Agreements
Taxation



Introduction

Introduction

Originally conceived as a vehicle for use by professional practices to obtain the benefit of limited liability while retaining the tax advantages of a partnership, LLPs have a far wider use as is evidenced by their increasing popularity as an alternative business vehicle in a wide range of sectors.

Key features

It first became possible to incorporate limited liability partnerships ("LLPs") in the UK in 2001 after the Limited Liability Partnerships Act 2000 came into force. LLPs have an interesting background. In the late 1990s some of the major UK accountancy firms faced big negligence claims and were experiencing a difficult market for professional indemnity insurance. Their lobbying of the Government led to the introduction of the Limited Liability Partnerships Act 2000 which gave birth to the LLP as a new business vehicle in the UK. LLPs were originally seen as vehicles for professional services partnerships as demonstrated by the almost immediate conversion of the major accountancy practices and a number of large law firms soon followed suit. However, professional services firms comprise a minority of the LLPs currently incorporated and they are now used more widely as a business structure.

An LLP is a different legal structure to both a traditional partnership established under the Partnership Act 1890 and a limited partnership established under the Limited Partnerships Act 1907. In fact, as a general principle, partnership law does not apply to LLPs. However, an LLP has some of the characteristics of both a traditional partnership and a private limited company and in many ways can be described as a company on the outside and a partnership on the inside. Legally it is defined as a body corporate with a legal personality separate from that of its members.

The LLP structure is attractive to a wide range of businesses and is becoming an increasingly common business vehicle used as an alternative to a company or partnership. The reason for its popularity is the flexibility which it accords its members, combining advantageous aspects of both companies and partnerships. Depending upon the circumstances an LLP may be a suitable stand-alone trading vehicle, holding entity in a group structure or the special purpose vehicle for a joint venture or strategic alliance.

The key features of an LLP are:

- limited liability for its members;
- a separate legal entity;
- taxed as a partnership;
- organisational flexibility;

- any members' agreement is a confidential document; and
- the accounting and filing requirements are essentially the same as those for a company.

An LLP can be incorporated with two or more members. A company can be a member of an LLP. As noted, it is a distinct legal entity from its members and, accordingly, can contract and own property in its own right. In this respect, as in many others, an LLP is more akin to a company than a partnership. The members of an LLP, like the shareholders of a company, have limited liability. As he is an agent, when a member contracts on behalf of the LLP, he binds the LLP as a director would bind a company. When a third party contracts with an LLP, unless he knows or believes otherwise, he is entitled to assume that the members are authorised to act on behalf of the LLP. Members are not jointly and severally liable for the contractual obligations of the LLP. Like a company, an LLP can create a floating charge over its assets.

The insolvency regime for LLPs is broadly the same as for companies. LLPs can propose a voluntary arrangement, apply to the court for an administration order, resolve to go into voluntary liquidation and resolve for the LLP to be compulsorily wound up by the court. Members of an insolvent LLP can be liable for fraudulent or wrongful trading in the same way as directors of a limited company. In addition, members can be required to repay drawings or other payments from the LLP received during the period of two years prior to an insolvent liquidation of the LLP if they knew or had reasonable grounds for believing that the LLP was unable to pay its debts at the time of withdrawal.

Incorporation and administration

Incorporation of an LLP is straightforward and simply requires filling in a prescribed form with the details of the first two members and the registered office which must be lodged at Companies House with the prescribed fee. The issues to consider when choosing a name for the LLP are very similar to those relevant to the choice of names for a company. Companies House will not register a name when it is the same as a name which is already registered. Certain names will require the



prior approval of the Secretary of State, such as “European”. You need to be aware of the risk of passing off by trading under a name already in use in your chosen area of business. It is important to check names already in use by searching domain name registries and on the internet.

Certain information similar to that relevant for a company must be filed at Companies House, including an annual return and any changes to the LLP's membership.

An LLP is required to prepare “true and fair” accounts, comply with the necessary accounting standards, have them audited if the audit threshold tests are exceeded and then file them at Companies House, where they will be available for public inspection.

An LLP must have at least two designated members. There is no specific definition of a designated member but his or her duties are those that would normally be carried out by a company officer and include responsibility for delivery of accounts and returns to Companies House. Ultimately it is for the members to decide what additional responsibility the designated members have and address this in the LLP members' agreement.

Members' Agreements

In some respects, however, LLPs do resemble traditional partnerships. An LLP has no share capital and is not subject to capital maintenance requirements.

There is scope for real flexibility in the arrangements between members. To change the capital and profit ratios between the members according to changing circumstances of individual members is straightforward and can be done from year to year. This compares favourably with the position in a limited company, where the articles of association and any accompanying shareholders' agreement would have to be amended with the consent of the shareholders. Profit distributions can be varied without regard to their respective capital contributions and capital surpluses can be allocated entirely independently of profit sharing. Goodwill may or may not be recognised on dealings between the members.

The relationship between the members themselves and the LLP should be fully documented in a members' agreement to which the LLP will generally be a party. Like a partnership agreement, this is a private document, and it need not be filed with the Registrar of Companies. It is important that the LLP members' agreement is comprehensive and properly drafted as otherwise the default provisions prescribed by law will take effect. Unintended consequences may arise as these rules provide that:

- all members will share equally in the capital and profits of the LLP;
- all members can take part in the management of the LLP;
- members are not entitled to any remuneration for management;
- no new members can join the LLP without unanimous consent of the other members;
- any difference arising on ordinary matters connected with the LLP's ordinary business may be decided by a majority of the members; and
- any proposed change to the nature of the LLP's business requires the consent of all members.

The members' agreement should set out how the LLP's profits and losses are to be shared amongst the members and deal with the appointment and retirement of members.

Typically, the agreement will also cover:

- funding and capital contributions;
- meetings, management and decision making;
- authority of members;
- expulsion or removal of members;
- financial consequences for a member leaving the LLP;
- any restrictions on competitive activities after leaving;
- designated members and their responsibilities; and
- insolvency of the LLP.

In addition, the provisions of the Companies Act giving a member the right to apply to the court if his or her interests are being unfairly prejudiced apply to LLPs. However, this can be excluded by agreement between the members for an agreed period of time and is a matter which should be addressed in the LLP members' agreement, if appropriate in the circumstances.

Generally, members of an LLP will not be employees and therefore not have the benefit of certain statutory employment rights. However, discrimination laws will apply and, in particular, the new age discrimination legislation may mean that compulsory retirement at a specified age for the members of an LLP will be discriminatory.

Taxation

The tax treatment of an LLP resembles that of a partnership rather than a company. The members are treated for the purpose of taxation as partners in that each is liable for the tax on his or her share of the income or gains of the LLP. Rather than being treated as employees, the members of an LLP are treated as if they are self-employed. Income tax and national insurance contributions are payable on a member's share of profits, however, as such amounts are not treated as salary, they do not fall within the PAYE regime and earnings will not be subject to employer's national insurance contributions.

Key personnel within the business of an LLP can be remunerated tax efficiently and in a flexible manner by their being appointed members of the LLP. Instead of being incentivised by way of equity based compensation, which may also be subject to income tax and national insurance contributions, the gain on an interest in an LLP will fall under the capital gains tax regime, which is likely to be more attractive than the income tax regime. If the interest is held for two years, full business asset taper relief may be available.

If members were employees within a company, income tax would be paid monthly. Individuals who are members of an LLP, in contrast, pay tax twice yearly under the self-assessment rules.

Often, one of the members of an LLP is a special purpose company. The special purpose company

will pay corporation tax on its share of the profits of the LLP. This is likely to be lower than the rate at which an individual is taxed.

Conclusion

Prior to embarking on a new venture, an LLP should be considered as a legal entity which may produce a flexible structure with advantageous tax treatment. It was said that the price for limited liability for LLPs is the requirement of disclosure of financial information. For anyone used to operating as a company, this will make little practical difference. In an age of increasing transparency, that may also be a small price to pay for traditional partnerships contemplating conversion to an LLP.

**For further information
on this subject please contact:**

Fergus Payne

Partner

T + 44 (0) 20 7074 8005

fergus.payne@lewissilkin.com

Clive Greenwood

Partner

T + 44 (0) 20 7074 8007

clive.greenwood@lewissilkin.com