EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY CONTRIBUTIONS (LIMITED LIABILITY PARTNERSHIP) REGULATIONS 2104

2014 No. 3159

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) on behalf of the Treasury and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument provides for certain members of a Limited Liability Partnership (LLP) - salaried members - to be treated for the purposes of the Social Security Contributions and Benefits Act 1992 (SSCBA 1992) and the Social Security Contributions and Benefits (Northern Ireland) Act 1992 (SSCB(NI)A1992) as employed in employed earner's employment. The consequence of this is that a primary and secondary Class 1 or Class 1A National Insurance Contributions (NICs) charge arises on their earnings or benefits from that employed earner's employment.

2.2 The instrument also modifies the definition of employer and employee in Parts 11 to 12ZB of the SSCBA 1992 and SSCB(NI)A 1992 so that salaried members are eligible for the statutory payments in those Parts.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 The Regulations have retrospective effect to the beginning of the tax year 2014/15. The power to make these Regulations retrospective is contained in section 4B of the SSCBA 1992 and section 4B of the SSCB(NI)A 1992. Both of these sections were amended by section 14 of the National Insurance Contributions Act 2014 which added section 4AA of both Acts into the definition of "relevant power". As a relevant power within section 4B, regulations made under the power in section 4AA can have retrospective effect where they are reflecting a retrospective provision of the Income Tax Acts which relates to income tax chargeable under the employment income Parts of the Income Tax (Earnings and Pension) Act 2003 (ITEPA 2003). These Regulations are reflecting sections 863A to 863G of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005), which is a retrospective provision, the effect of which is to make income received by salaried members from an LLP subject to tax under the employment income Parts of ITEPA 2003. These Regulations therefore reflect a retrospective tax

provision that relates to income tax chargeable under the employment income Parts of ITEPA 2003.

4. Legislative context

4.1 The instrument is the first to be made under Section 4AA SSCBA 1992 and SSCB(NI)A 1992 and will have retrospective effect from 6 April 2014.

4.2 The instrument is being made to ensure that a Class 1 or Class 1A NICs charge arises on payments and other benefits to salaried members, who are treated for tax purposes as employees by virtue of section 863A ITTOIA 2005 (see Part 1 of Schedule 17 to Finance Act 2014).

4.3 This instrument has the following provisions:

- where an individual is treated by virtue of section 863A to 863G of ITTOIA 2005 for income tax purposes as being employed under a contract of service with employment income ("the deemed tax employment"), the individual is treated as an employed earner for NICs purposes and the employment income from the deemed tax employment, excluding employment income under the benefits code, is treated as earnings for NICs purposes and therefore subject to Class 1 contributions. It follows that employment income under the benefits code from the deemed tax employment is subject to Class 1A contributions pursuant to section 10 of SSCBA 1992 and SSCB(NI)A 1992;

- the LLP will be the secondary contributor in relation to the salaried member for the purposes of Class 1 and Class 1A contributions;

- the SSCBA 1992 and the SSCB(NI)A 1992 is modified to make salaried members employees and the LLP their employer for the purposes of the statutory payment regimes so that salaried members are eligible to receive statutory payments;

- a double charge will not arise where effectively the same income falls within these provisions and those in the Social Security Contributions (Intermediaries) Regulations 2000 or the Northern Ireland equivalent Regulations. Where that occurs, these provisions will take priority.

5. Territorial extent and application

5.1 This instrument extends to all of the United Kingdom but regulations 3 and 6 extend only to Great Britain and regulations 4 and 7 extend only to Northern Ireland.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, David Gauke, has made the following statement regarding Human Rights:

In my view the provisions of the Social Security Contributions (Limited Liability Partnership) Regulations 2014 are compatible with the Convention rights.

7. Policy background

- **What is being done and why**

7.1 HMRC is treating for tax and NICs purposes certain members of an LLP as employees who had previously been treated as self employed.

7.2 All members of an LLP were previously treated for tax and NICs purposes as if they were self employed. The members benefit from the rules applying to the self employed and the LLP does not have to pay employers' NICs.

7.3 Some LLPs were allowing certain individuals to become members who would be employees if the LLP structure did not exist. The tax legislation introduced by Finance Act 2014 provides that where a member ("M") of an LLP satisfies certain conditions (set out at new sections 863A to 863G of ITTOIA 2005), they will be treated for income tax purposes as if they were employees of the LLP and the LLP will be treated as their employer for the purposes of employment taxes. The conditions are:

- Condition A is that it is reasonable to expect that at least 80% of the total amount payable by the LLP in respect of M's performance of services for the LLP will be fixed, or if variable, variable without reference to, or in practice unaffected by, the overall profits or losses of the LLP ('disguised salary').
- Condition B is that the mutual rights and duties of the members and the LLP and its members do not give M significant influence over the affairs of the LLP.
- Condition C is that M's contribution to the LLP is less than 25 per cent of the disguised salary which it is reasonable to expect will be payable by the LLP in a relevant tax year in respect of M's performance of services for the LLP.

7.4 The tax legislation also provides that where an individual is providing services to the LLP via an intermediary that is a member of the LLP and if the individual providing the services were in fact a member of the LLP rather than the intermediary, the individual would satisfy the conditions A to C above, that individual will be treated for income tax purposes as if they were an employee of the LLP and the LLP will be treated as their employer for the purposes of the employment taxes.

7.5 The Regulations mirror the tax provisions and provide that where individuals meet all three of these conditions (and which includes the case where an individual has interposed an intermediary between themselves and the LLP), they will also be treated as employed earners for the purposes of NICs.

7.6 The Regulations also ensure that where individuals are treated as employed earners as a consequence of the Regulations, they will be entitled to statutory payments such as sick pay and maternity pay.

- **Consolidation**

7.7 There are currently no plans to consolidate this instrument.

8 Consultation outcome

8.1 HMRC carried out a formal consultation between May and August 2013 on changing certain partnership tax rules - *Partnerships: A review of two aspects of the tax rules:* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/200503/130520_Pships_Condoc_FinalVersion.pdf. The document made clear that legislation removing the presumption of self-employment and introducing a specific statutory test for salaried members would be introduced as part of Finance Bill 2014 and would have effect from 6 April 2014.

8.2 About 110 responses were received. These focused on whether the status of members should be left to traditional employment status tests or whether a statutory definition is needed.

8.3 A response document was issued on 10 December 2013 (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/264652/partnerships_-_a_review_of_two_aspect_of_the_tax_rules.pdf) alongside draft Finance Bill 2014 legislation. The response document reaffirmed the Government's intention to introduce a specific statutory test and that the legislation would take effect from 6 April 2014.

8.4 Technical consultation on the draft tax legislation concluded on 4 February 2014. Revised draft legislation was published on 7 March and introduced as part of Finance Bill 2014 on 27 March 2014, and Royal Assent was received on 17 July 2014.

8.5 A draft of these Regulations was published for technical consultation on 16 April 2014. No comments were received.

9. Guidance

9.1 The latest guidance on the new partnerships legislation was published on 27 March 2014 and is available on the GOV.UK website: https://www.gov.uk/government/publications/salaried-member-rules-legislation-day-technical-note-and-guidance.

10. Impact

10.1 There will only be an impact on LLPs that have salaried members. The Partnerships Review measure comprises a number of elements which will bring in total tax and NICs revenue of £3.27 billion over the forecast period to 2018-19.

10.2 A Tax Information and Impact Note covering this instrument was published on 5 December 2013 and is available on the HMRC website at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263833/131205_NICs_Bill_Partnerships_TIIN.DOC. This remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 This statutory instrument will impact across businesses which operate as LLPs and this includes small business.

11.2 The wider policy is aimed at all sectors that use the LLP structure. To exempt small business would be inconsistent with the policy objective to prevent tax and NICs loss that may arise when LLP members are employed on terms closer to employment.

12. Monitoring and review

12.1 The purpose of this instrument is to prevent the use of LLPs from disguising what would otherwise be an employed earner status for NICs purposes.

12.2 HMRC will monitor the effectiveness of the instrument to ensure the Government objectives are met.

13. Contact

13.1 Adrian Dixon at HMRC (Tel: 03000 586934 or email: Adrian.Dixon@hmrc.gsi.gov.uk) can answer any queries regarding the instrument.