LIMITED LIABILITY PARTNERSHIPS

FREQUENTLY ASKED QUESTIONS

HAGGARDS CROWTHER

CHARTERED ACCOUNTANTS & TAX ADVISERS

Limited Liability Partnerships (LLPs) are a useful corporate vehicle that can provide flexibility where Limited Companies are rigid.

In this booklet we answer some Frequently Asked Questions, which provide an overview, about LLPs that explains the basic framework of compliance and the commercial and tax aspects of being a partner

Contents

1. What is a limited liability partnership (LLP)?

An LLP is a body corporate with a legal identity separate from its members, also known as partners. It is a type of legal structure for businesses of all sizes and sits somewhere between a traditional, unincorporated partnership and a limited company.

2. How is an LLP different from a traditional unincorporated partnership or a limited company?

For legal purposes an LLP is very similar to a limited company in that generally a member's liability is limited to the amount of capital they invest in the business. The flexibility of the partnership can make an LLP a more appealing option for many small (and large) businesses then a Limited Company.

The word partnership means that the human members of it are self-employed for the purpose of tax and the profits and losses of the LLP and any capital gains are shared between the members in accordance with the agreed sharing ratio and taxed at the income tax or capital gains rates applicable to individuals. In contrast, companies pay corporation tax on trading profits and gains.

3. What are the advantages of choosing an LLP for my business?

An LLP has the organisational flexibility of a traditional partnership so the constitution is set by the members through the partnership agreement and not subject to the detail of the Companies Act. The governing legislation is the Limited Liability Partnerships Act 2000. In other words, if you want to do something as members, you probably can.

A further advantage comes when a new member is introduced, or an existing member retires, the process is more straightforward as usually employment law is not a consideration. Just follow the partnership agreement.

Careful consideration must be given to the tax implications of self-employment. The advantage of an LLP is that the LLP is not taxed, it is the members who are taxed so each member can look after their own affairs irrespective of what other are doing.

Members of an LLP will usually pay a lower overall rate of tax than the owner-managers of a Limited Company. This is because corporation tax is paid by a company and dividend tax by the shareholder. Self employed income is subject to income tax and National Insurance and chargeable gains to Capital Gains tax.

4. How can I set up an LLP?

Forming an LLP is similar to forming a company. Two or more persons, known as initial subscribers, must deliver an incorporation document to the Registrar of Companies. There is usually a small fee for this.

5. Should the LLP have a partnership agreement?

Yes, the LLP should have a partnership agreement. Though not legally required, the agreement lays out the members' understanding of how the LLP is governed and we recommend one is put in place at the start of the business. The agreement should cover, amongst many other things, how the trading profits and losses are shared between members, how capital gains are split, how much capital the members must put in, how decisions are made, members' responsibilities and how members join or leave the LLP.

6. What are the LLP's compliance obligations?

LLPs must have at least two designated members – a role very similar to that of directors of companies. They are the members who are responsible for the management of the LLP. Their responsibilities include filing certain notices with the Registrar at Companies House (such as when a member leaves), signing and filing accounts and appointing auditors (if required).

HM Revenue and Customs

When an LLP is first formed, it is registered it with HM Revenue & Customs (HMRC). The nominated partner is responsible for completing the LLP tax return, which contain details of the LLP's trading profit or loss and other income received by the LLP, as well as showing each member's share of the profits and losses and any proceeds from asset disposals.

In addition, each member should register with HMRC as self-employed within three months of being admitted as a member of an LLP.

Companies House

Financial statements, also known as Accounts, must be filed with Companies House once a year usually within nine months of the end of the reporting period covered by the accounts.

The LLP must also file a Confirmation Statement at Companies House and maintain an accurate and up to date register of persons with significant control (PSC) and ensure this is accurately reflected at Companies House.

The Confirmation Statement provides details of the members and is filed once a year on the anniversary of incorporation. Any updates to the PSC must be filed within 14 days of the change.

7. What should I include in my LLP accounts?

The members of the LLP must prepare Financial Statements, for each financial year. Generally, the accounts should include an income statement, a balance sheet signed by a designated member on behalf of the board and notes to the accounts.

In some instances, accounts must also be accompanied by an auditors' report stating the name of the auditor and signed and dated by them. This will not be the case if the LLP is exempt from audit.

All LLPs must file their accounts at Companies House.

Small and micro LLPs can take advantage of legislation and prepare less detailed versions of the financial statements.

8. I've heard people say that my accounts will have a balance sheet and a profit and loss. I have no idea what this means.

The designated members are responsible for the preparation and approval of the LLP's accounts which include the balance sheet and the profit and loss account.

The balance sheet is a snapshot at the date of the accounts of the assets and liabilities of the LLP. In other words the total of what it owns and is owed less what it owes to others.

The profit and loss account, or income statement, shows how much money the LLP has made or lost in the year. To calculate the profit or loss, the LLP deducts the expenses from its total income.

There are two main categories of expenses:

- Cost of sales, which are the costs directly linked to turnover, e.g. the cost of an item then resold; and
- Administrative expenses, which are costs linked to the running of the business such as office rent and accounting fees.

9. I don't want all of the LLP's financial details to be available for everyone to see. Do we have to send all this information to Companies House?

Due to the limitation of liability, an LLP must file accounts with Companies House so potential suppliers can assess creditworthiness.

Under UK reporting rules, accounts include a profit and loss account, balance sheet and supporting notes. However, small and micro LLPs can take advantage of exemptions, which allow them not to file a profit and loss account, so the profit made is not on the public record if the members do not want it to be.

10. How do I take money out of the LLP?

Members of an LLP will not know how much they have earned until the end of an accounting year, but they do not expect to wait until the end of the accounting year to receive income. Therefore, during the year, they draw amounts, usually monthly, on account of the profit share that is expected for the year. Such withdrawals from the LLP are known as 'drawings' as in drawings against profits.

Members can usually, subject to a partnership agreement, withdraw available cash from the LLP at any time during the year.

Note: Drawings are ignored for the purposes of calculating the amount of tax due by members as they are taxed on their respective share of the LLP profits. In some cases members may be taxed on profits they haven't received in cash. In others, they may receive more cash than the income they pay tax on.

11. What are the tax implications of running an LLP?

For tax purposes, LLPs are treated as 'transparent' and are not themselves taxable entities. The trading profits of an LLP are subject to income tax for individual members and corporation tax for corporate members based on each member's share of the underlying profit.

LLP trading profits attributed to individual members are liable to Class 4 National Insurance contributions and Class 2 National Insurance where their earnings from the LLP exceed certain limits.

12. When is the LLP tax return due?

The filing deadline for the LLP tax return is the standard self-assessment filing deadlines, usually 31 January following the tax year end.

If the nominated partner fails to file the LLP return, each member will be liable to a late filing penalty.

Although the LLP is required to complete a tax return annually, it is not a taxable entity itself so there is no concept of an LLP tax liability. It is the individual members who will pay the tax via their self-assessment tax returns.

13. In which tax year will my profits be taxed?

From the tax year 23/24 partners will be taxed on profits for the year to 31 March each year, irrespective of the financial year end of the partnership.

In the past, the taxable profit of an LLP member is calculated by reference to the profit for the accounting year ending in the tax year. For example, if an LLP's accounting year end is 31 December, the profit for the year ended 31 December 2022 is taxable in the tax year to 5 April 2023. Special rules apply in the opening and closing years of trade which gave rise to overlap profits and there are transitional adjustments for those partners where the year end did not run to 31 March each year.

14. How much money should I set aside to pay the LLP's tax?

Although an annual LLP return is required, LLPs are transparent for tax purposes, so the LLP itself does not have a tax liability. The individual members are responsible for preparing and filing Self-Assessment tax returns for HMRC and paying their own tax liabilities for their respective share of profits.

How much cash each member sets aside for income tax will vary from member to member and depends on the LLP's profit sharing ratio, the level of LLP profits, the individual member's total income and the allowances and reliefs available to them.

The rate of tax for basic rate taxpayers is 20%, for higher rate taxpayers it is 40% and additional rate taxpayers it is 45%.

Individual members are regarded as self-employed for National Insurance purposes so are required to make Class 2 and Class 4 National Insurance Contributions (NICs). The amount of Class 2 and 4 NICs due must therefore also be considered in determining how much tax to set aside.

For 2023/24, the Class 2 contribution is £3.45 per week and the Class 4 contribution is 9% of taxable trading profits between £12,570 and £50,270 plus 2% on the rest. Class 2 and 4 NICs are payable at the same time and on the same basis as income tax.

We know that cash flow can sometimes be an issue, so assessing the ongoing profitability of the LLP is important when making decisions about how much cash to set aside for tax.

Some LLPs set aside cash to pay partners' tax liabilities

15. When should I pay the tax?

Income tax and Class 2 and 4 contributions are generally payable on 31 January following the relevant tax year.

Where an individual's tax liability is in excess of £1,000, HMRC requires that they make payments in advance of the following tax year (known as payments on account). These payments consist of two instalments equal to 50% of the prior year's income tax liability.

The payments on account are due on 31 January and 31 July following the end of the tax year.

A balancing payment may also be due on 31 January after the end of the next tax year if the instalment payments prove to be less than the actual liability for the year. Penalties and interest can apply in respect of late payments.

16. What if the LLP makes a loss?

If the LLP makes a loss, it is allocated to the members in accordance with the partnership agreement. Usually this is in the same proportions as profits but members may chose a different split.

In most instances, trading losses can be offset against a member's other income or capital gains arising in the current or preceding tax year. However, it should be noted that the losses that they can offset against other income or capital gains are limited to an amount equal to their capital contribution to the partnership.

Alternatively, the losses can be carried forward and offset against the member's share of future profits.

There are special rules for using losses in the opening and closing years of trade.

Relief for losses is also restricted further for members who do not spend more than 10 hours per week on average personally engaged in activities carried on for the purposes of the trade.

17. Can I set up a bank account in the LLP's name?

Yes, an LLP can set up bank accounts and should do to support its ongoing trade.

18. What records should I keep?

Every LLP, whether or not they are trading, must keep accounting records. These must contain: entries showing all money received and spent by the LLP and a record of the assets and liabilities of the LLP.

LLPs must keep accounting records as required by legislation for at least 6 years.

19. I may need to employ some staff. Does the LLP need to operate a payroll and pay pension contributions?

Yes, most LLPs will need to register as an employer under PAYE when they start to pay staff. The only exception to this is if none of the staff is paid more than the national insurance lower earnings threshold of £123 per week (or £6,396 per year.

Where applicable, the LLP must register as an employer with HMRC, deduct tax from the employee under 'Pay as you earn' (PAYE) and pay it to HMRC. The LLP must register before the first payday.

The Real Time Information (or RTI) system is used to report PAYE information to HMRC. It is referred to as RTI because the employer must send details to HMRC every time they pay an employee, at the time they pay the employee. In other words, the information must be reported in 'real time'.

Employers usually pay the PAYE tax and NIC to HMRC on a monthly basis. The due date for payment is on the 22nd of each month. However, where PAYE and NIC are not paid electronically, the due date is the 19th of each month.

All employees are now required to be automatically enrolled in a pension scheme unless they opt out. Employees are currently required to pay 5% of their gross salary while employers pay 3%. The LLP is obliged to manage the pension contributions on behalf of the employees.

20. What expenses can I claim through the LLP?

Expenses that are incurred wholly and exclusively for the purposes of the trade are allowed as a deduction for tax purposes.

There are a number of expenses, such as business entertaining and depreciation, which, although incurred wholly and exclusively for the purposes of the trade, are not allowable as a deduction for tax purposes and must, therefore, be added back to the accounting profit in calculating the profits subject to tax.

The cost of business travel while visiting destinations away from a member's usual place of work are allowable, as are any incidental expenses incurred on these trips, such as food and drink.

If the business is run from home, members can deduct a proportion of their expenses incurred on rent, maintenance, utility bills, property insurance, and security, but they will need to work out the proportion of their home that is used for business.

If a member works from home at least 25 hours a month, a 'simplified expenses' method can be used, which is a flat monthly rate calculated by the government.

Some items that an LLP purchases will be regarded as capital items, and as such will not ordinarily be allowed as a deduction against profits. However 'capital allowances' can be claimed on many of these items, with relief of up to £200,000 of expenditure being available on such items each year.

21. Can I use a car owned by the LLP?

Yes, but if the car is used for any personal trips then an apportionment is taken and the costs of any personal use added back to the LLP profits and subject to tax.

22. Do I need to register for VAT?

An LLP does not automatically need to register for VAT.

Registration for VAT is compulsory for any business (LLP or otherwise) with a taxable turnover in excess of the VAT registration threshold, currently £85,000.

Once registered, VAT is added to the value of the services or goods the LLP supplies on its invoices. VAT is also reclaimed on purchases of goods and services used in the trade.

Where the businesses turnover does not exceed the threshold, the LLP has the option to voluntarily register for VAT, which allows the recovery of input VAT on purchases and can be beneficial for many businesses.

23. What are the bookkeeping options for the company?

In its simplest form bookkeeping is just keeping a record of the transaction of the LLP and can be done using a spreadsheet. Improvements in online accounting software mean that it is now possible to download bank transactions directly into the company's books. The download is not the complete bookkeeping process as the transactions must be correctly analysed, but it does speed things up significantly.

Some business owners like to do the bookkeeping themselves either to keep costs down or because they wish to understand the detail. Others will employ a bookkeeper to come and work at their office (a good solution if transaction volumes are high and there is a need for day to day liaison with managers and other employees).

Haggards Crowther can provide a bookkeeping service alongside reviewing and filing VAT returns and management information or as part of a more regular service. We work with many types of software including but not limited to Xero, Sage, Quickbooks and FreeAgent.

24. I have heard people talk about Making Tax Digital (MTD). Does this mean that my records must be held digitally?

HMRC has a longstanding goal to digitise all tax records, with the aim to close tax deficits and make it easier to identify the sources of its income. To do this, HMRC is rolling out an initiative called MTD. The only tax that so far has a definitive date for being digitised is VAT, with all other digitalisation being pushed back at least April 2024.

We recommend that any business exceeding or approaching the VAT threshold consider accounting software to keep accurate records.

25. Do I need insurance and professional indemnity insurance?

Members in an LLP are jointly and severally liable for the LLP's debts. Despite the limitation of liability that an LLP gives the members, it is therefore usually sensible to take out insurance to cover exceptional circumstances.

The LLP may need Professional Indemnity Insurance to cover work that it does if it is supplying services or product insurance if it is supplying goods.

If you have other questions or would like to speak to one of our new business specialists please call Haggards Crowther on 020 7384 0920.

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