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Attention: Richard Rogers
HM Revenue & Customs
100 Parliament Street
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By Email and Post

4th February 2014

Dear Sir

Revenue Law Committee comments on draft Finance Bill 2014 Partnership proposals

The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. These comments have been prepared by the CLLS Revenue Law Committee.

Our principal concern is with the "Salaried Members" legislation. We believe that the tests are poorly drafted, leading to unsatisfactory (over-)reliance on (entirely non-binding) HMRC guidance. The guidance contained in the technical note is confused in a number of different areas, and needs to be dramatically improved. Given the time and effort spent engaging with HMRC during the consultation process, it is particularly disappointing to find ourselves in this position at this time (less than four months before the majority of the new rules are intended to take effect), and calls into question whether it is worthwhile devoting such time and effort to future consultations.

We also believe that affected (or potentially affected) businesses have had insufficient time to prepare. The rules come into effect on 06 April 2014. Due to the breadth and complexity of the rules, businesses are currently still uncertain as to whether they are likely to be caught or not, and are awaiting revised legislation and guidance on 17 February, which will hopefully provide some much needed clarity. Assuming it does, businesses, some of whom will be subject to significant regulatory oversight, will have six weeks to consider the impact of the rules on them and how they might need to

restructure. This assumes that the rules are not changed during their passage through Parliament as part of the Finance Bill (it is very unsatisfactory that businesses are having to restructure from 06 April 2014 based on measures that, even if unchanged, will not become law until the Finance Bill receives Royal Assent in July 2014). We therefore believe that the rules should be deferred until 06 April 2015, which will give HMRC time to work with taxpayers to produce a more coherent set of rules and guidance, and, more particularly, will give taxpayers time to properly consider how the rules will affect them and to act accordingly.

"Salaried members" legislation

1. **Condition A – payment for provision of services**

1.1 We understand that HMRC intends to make clear that to the extent a pool of profits of an LLP is allocated between members based on their personal performance, such amounts will not be regarded as disguised salary. We welcome this approach. We also understand that HMRC intends to make clear that to the extent a pool of profits of an LLP is allocated between members based on a lockstep system, or on the basis of an "eat what you kill" system or any other performance related system (whether formulaic or otherwise), such amounts will also not be regarded as disguised salary. Again, we welcome this approach. We consider it vital that the HMRC guidance includes examples to illustrate this and makes it very clear that the key distinction is where a member's share is not ultimately linked to the actual profits (which would be disguised salary). This is particularly important if clarificatory changes to the relevant part of the proposed legislation are unlikely to be made.

1.2 As currently phrased, s.863B(1) only looks at amounts payable to M by a UK LLP of which M is a member in respect of M's performance of services. Professional services firms and also some asset managers and other businesses will often be structured as a series of partnerships in different jurisdictions, which may involve individuals being partners in more than one partnership and receiving different allocations of (entirely genuine) profits from such different partnerships. There will be local regulatory reasons for such structures. Ultimately profit allocations received by an individual from those different partnerships will all be in respect of his performance of services for the UK LLP. We would therefore suggest amending the drafting of section 863B as follows (amends shown in red):

863B Conditions A to C

(1) Condition A is that there are arrangements in place as a result of which –

(a) at or after the time at which it is being determined whether that condition is met, M is to perform services for the limited liability partnership in M's capacity as a member of the partnership, and

(b) it is reasonable to expect that the amounts payable by the limited liability partnership, or by the limited liability partnership together with any amounts payable by any other partnership of which M is a partner, in each case in respect of M's performance of those services will be wholly, or substantially wholly, disguised salary.

(2) An amount is "disguised salary" if it –

(a) is fixed,

(b) if it is variable, is varied without reference to the overall amount of profit and losses of the limited liability partnership (or, if amounts are also paid by another partnership of which M is a partner in respect of M's performance of services for the limited liability partnership, without reference to the overall amount of profits and losses of the limited liability partnership and that other partnership), or

(c) is not, in practice, affected by the overall amount of those profits or losses.

1.3 Professional services (and also certain other) LLPs will usually produce a budget at the beginning of their financial year. Monthly advances of drawings will be made to members of the LLP based on the anticipated level of budgeted profits, although different firms will be more or less cautious in this respect. So for example, if LLP A expects to make £2 million of profits in a particular financial year, it may only budget to pay out £1 million by way of monthly advances of drawings, with the remainder of any realised profit being paid out by way of a lump sum, allocated based on any number of different criteria, following the end of the financial year. LLP B however, which also expects to make £2 million of profits in a particular financial year, may budget to pay out the entire £2 million by way of monthly advances of profit. In either case, if such profits are never realised, the members would have to repay such profits (although there may be a priority of repayments, such that senior members have to repay before junior members). In the case of LLP A, it may be extremely unlikely that LLP A ever makes less than £1 million of profit, and therefore it may be extremely unlikely that the members of LLP A would ever have to repay any advances (leaving aside any priority of repayment). However, we believe that both the monthly advances of drawings and any allocations of residual profit should not be treated as disguised salary for any member of either LLP A or LLP B. It would be helpful if HMRC could confirm their agreement on this point by way of an example in the revised guidance.

1.4 LLPs may from time to time hire senior individuals into the businesses, and agree to pay them "guarantees". Such arrangements can take a number of different forms. Some (probably the minority) will be unconditional obligations of the LLP to pay a particular amount of money, irrespective of the level of profits of the LLP. Any stated amount would presumably be regarded as being disguised salary on the basis either that it is fixed or that it is not, in practice, affected by the overall amount of the profits and losses of the LLP. Some "guarantees" are however conditional in nature, such that they are essentially preferential shares of profits of the LLP, and if there are no profits then no payments will be made pursuant to the guarantee. Such preferred shares of profits are no different to the fixed monthly advances of drawings set out above, and in the same way should not be treated as disguised salary. Of course, the comments at paragraph 1.2 above apply equally in the context of "guarantees" where the amount may be conditional on worldwide profits.

1.5 It would seem to us that the fact that an LLP has predictable profits (for example, because it manages a private equity fund and has a single fund management contract with the fund under which it receives a predictable management fee and no performance fee) should not cause any allocation of those predictable profits to the members of the LLP to be disguised salary.

1.6 We understand that HMRC does not believe that a structure whereby a UK LLP carries out functions for which it is remunerated on a "costs plus" basis should inherently be treated any differently to any other trading LLP. In the "costs plus" model, the LLP will usually have a single contract with another entity under which that entity has delegated certain services to it. The fee payable under the contract to the LLP will include an element to reimburse the LLP for certain costs, such as staff and premises costs and a markup on these costs. To the extent that, under the terms of the arrangements, the members of the LLP have also performed in such a way that variable remuneration is due to them, then the fee will be increased by the amount of such variable remuneration to ensure that the LLP has sufficient profits to pay such variable remuneration. It would be helpful if HMRC could confirm their agreement on this point by way of an example in the revised guidance.

2. Condition B – significant influence

2.1 HMRC states that this condition is about testing whether "the individual is the business rather than merely working for the business" (p.12 of the Technical Note). They go on to say that "the affairs of the partnership to be considered are more than voting for the managing committee or the firm's accounts and look at whether there is a significant influence over the business as a whole". It would be helpful to understand how much more influence a member would need to have to fail to meet this condition. Or is it the case that HMRC believe that, where a firm has a management committee, a member who is not on that committee will never have significant influence? If this is the case, it should just say so clearly. However, we believe that HMRC would be mistaken in adopting such a view. Within many LLPs, the "equity" partners all have equal votes on a whole variety of matters – admitting new partners to the LLP, any amendments to the terms of the LLP agreement, any significant strategic decision the LLP may take, such as a merger with another firm. These rights are not given to such members as a fudge to allow them to be considered partners when otherwise they might have been considered employees – they are rights consistent with ownership of a business, and are exercised as such, notwithstanding that the day to day management of many aspects of the business, for practical reasons, may well have been delegated to a management committee of the sort HMRC flag in their guidance. In a corporate context, these would be shareholder rights – they are not rights consistent with those that one would expect an employee to have. Further, we would contend that there are a number of other positions (apart from management committee positions) where significant influence over a particular area of any LLP's business is exercised. For example, members of "investment committees", "keymen", "compliance officers", "chief financial officers" and "chief operating officers". We would therefore suggest HMRC revisit its interpretation of "significant influence" with this in mind.

3. Condition C – contribution to the LLP

3.1 Outside of professional services firms, it is very unusual for members to be required to contribute amounts of capital to an LLP where those amounts are significant in the context of the level of remuneration which a member might receive if he, and the business as a whole, have a "good year". Such businesses often do not require significant levels of working or regulatory capital. Whilst financial investment in the business may be required, such investment may well take the form of a stake in an investment fund managed by the LLP rather than the LLP itself. If you take the example of a portfolio manager at a hedge fund, who may hope to earn £1 million if the fund he manages does well, it would make

no sense from a business perspective for him to have contributed £250,000 to the LLP (as opposed, for example, to the fund he manages). Typically, individual members of LLPs will have contributed sums in the region of £5,000 - £10,000 – we believe that such sums are sufficiently material that they should count as capital contributions. An absolute threshold amount of this type of level would be far more preferable than the proposed "25% of the total amount of disguised salary which, it is reasonable to expect, will be payable in the relevant tax year" formulation.

3.2 Within professional services firms, the funding requirements of the business may be met in a number of different ways. The firm may arrange for individual members to take out bank loans, with the resulting proceeds being injected into the business as partnership capital. Alternatively, the firm may borrow from the bank, against personal guarantees of the relevant shares from each individual member. In the former circumstance (depending on the amounts), Condition C would not be met. In the latter, based on HMRC's guidance at page 15 of the Technical Note, Condition C would be met. This is a ridiculous outcome – the economics of these two arrangements, for the firm, the bank and the members, is the same. We suggest that Condition C, and the guidance thereon, is amended to deal specifically with this point.

4. Consequences of "salaried membership"

Employment-related securities

4.1 The proposed new section 863A(2) provides that "For the purposes of the Income Tax Acts – (a) M is to be treated as being employed by the limited liability partnership under a contract of service instead of being a member of the partnership, and (b) accordingly, M's rights and duties as a member of the limited liability partnership are to be treated as rights and duties under that contract of service."

4.2 HMRC's guidance at p23 of the Technical Note states "The interest received by a Salaried Member when becoming a member of the LLP is not itself considered to be a benefit for income tax purposes." HMRC have, quite correctly, historically not regarded interests in a trading LLP as falling within the definition of a "security" for the purposes of s.420 ITEPA (employment related securities rules definitions). We assume this will continue going forwards. However, is it HMRC's intention that one of the consequences of being a "salaried member" is that the employment-related securities rules will come into play for such a member? Even if the LLP interest is not an employment-related security, a member of an LLP may also acquire other securities (such as an interest in the US parent entity of a UK "subsidiary" LLP in the asset management sector). It would be helpful if HMRC could clarify this point (and also amend the relevant primary legislation to make it clear that this is how the rules are intended to work).

5. Overlap relief

5.1 If a member is treated as a salaried member, he will cease to carry on a notional trade, and a deduction will be due under section 205 ITTOIA (overlap relief) against his profit from that trade in his final year before becoming a salaried member. HMRC need to explain in some detail the consequences of these rules in the context of overlap relief. It would be helpful if HMRC could provide an

example of how it would see this working in terms of tax compliance for the relevant member.

6. **TAAR**

6.1 We understand that HMRC is proposing to redraft the TAAR to make it clear that where arrangements between an LLP and a member are altered in such a way to ensure that the member is not treated as a salaried member, and such arrangements have real commercial consequences for the member, the TAAR will not be applied. From the perspective of certainty, it is important that the TAAR is clearly limited in this way in primary legislation, rather than relying on guidance that HMRC will not seek to apply it in particular ways. If this request is to be ignored, then the guidance should include suitable examples to provide comfort on this and ultimately some form of certainty.

6.2 By way of example, if an individual member chooses to contribute sufficient capital that he fails to meet Condition C, but would not otherwise have contributed such capital, then the TAAR should not apply. However, if such capital is then immediately lent back to the individual on terms that do not provide for repayment or interest, then it may be appropriate to apply the TAAR in these circumstances.

7. **Other comments**

7.1 If a member becomes a salaried member, we assume that HMRC will regard it as appropriate for that individual to begin to participate in arrangements such as salary sacrifice, whereby an employee will often give up a part of his salary in exchange for his employer making a contribution into the employee's registered pension scheme.

7.2 Please find enclosed a copy of our letter to the House of Lords Economic Affairs Finance Bill sub-committee dated 23rd January 2014. We wish HMRC to also take note of the other points made in that letter not covered here.

Yours faithfully,

Bradley Phillips
Chair
The City of London Law Society Revenue Law Committee

THE CITY OF LONDON LAW SOCIETY
REVENUE LAW COMMITTEE

Individuals and firms represented on this committee are as follows.

B.S. Phillips (Herbert Smith Freehills LLP) (Chairman)

H. Barclay (Macfarlanes LLP)

B. Coleman (Ropes & Gray International LLP)

C.N. Bates (Norton Rose Fulbright LLP)

D. Friel (Latham & Watkins LLP)

D. Oswick (Simmons & Simmons LLP)

D. Winter (Linklaters LLP)

C. Hargreaves (Freshfields Bruckhaus Deringer)

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The FSBC
The House of Lords Economic Affair Committee

23 January 2014

Dear Sirs

Response to proposed changes to partnership taxation

1. The City of London Law Society ("CLLS") represents approximately 15,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues. As such our members have a very direct interest in the proposals for changes to partnership taxation, as well as being concerned on behalf of their clients.

2. We have extremely grave concerns about there being tax provisions which treat one form of partnership very differently to other forms of partnership (as is the result of the LLP salaried member proposals) and over the way in which these measures are being implemented, which we think are contrary to the principle of legal certainty by which the UK sets so much store in measuring its international competitiveness. We think that as currently drawn the measures go too far, and would apply in circumstances which are not offensive when tested against the professed policy behind the changes. Of particular major concern is that we would dispute key aspects of HMRC's proposed interpretation of the new legislation as set out in the "HMRC Technical Note and Guidance" published alongside the draft legislation.

3. We also note that the measures will cause serious difficulties for the asset management industry, potentially leading to a materially higher tax burden for businesses operating in that sector. Indeed, the documentation published by HMRC in December explicitly stated that they had been surprised at the extent to which it would affect alternative investment managers and had accordingly increased the estimated tax take. This is of course an entirely legitimate policy choice of government. However, these measures were announced last summer almost simultaneously with the launch of the Government's investment management strategy by Treasury ministers, at which the Economic Secretary to the Treasury stated that: "In short, our mission is to make the UK the most competitive location for funds. We want funds domiciled here. And we want funds managed here." There is an evident serious inconsistency in policy here which is extremely regrettable. We also very much hope that it remains Government policy to support the UK as a base for professions.

4. This submission focuses on the "salaried member" proposals as these raise particular difficult policy issues and are the most relevant to the membership of the CLLS. However our concerns about process and timing apply equally to the "mixed membership" part of the proposals as well (where there will be situations where

genuine commercial arrangements are going to be caught by the new taxing provisions, unfairly in our view).

The policy background

5. Historically in the UK businesses providing professional advice almost invariably constituted themselves as partnerships for a variety of commercial, regulatory, tax and cultural reasons. However, following the great expansion of the City of London in the 1980s, concerns began to arise that the unlimited liability borne by partners was not appropriate in the context of the size of those businesses and the risks to which they were unavoidably exposed.

6. The largest accountancy firms in particular undertook quite a lot of work to investigate whether it would be possible to move their legal seats, although not places of business, to Jersey, whose government obligingly legislated to bring into existence a partnership with limited liability that could be utilised by such a firm.

7. The UK government of the day responded by opening a consultation on the possibility of creating an entity which would have most or all of the liability-limited features of the limited company, but would offer tax consequences similar to that of a partnership. This was clearly considered important to ensure that the UK (and the City of London) remained a leading centre for financial and professional services. This led to the creation of the UK LLP under the Limited Liability Partnerships Act 2000.

8. The tax policy intention behind the 2000 Act (and consequential amendments to the various taxes acts) was explicit: "Members of an LLP will be treated for income and capital gains tax as if they were in a conventional partnership". (*House of Commons Research Paper 00/54, 22 May 2000, note on Clause 10 of the LLP Act.)*

9. At the time, there was substantial agreement as to the merits of the proposals. They were first put forward by John Major's Conservative government in its latter days, and were carried through to fruition by Tony Blair's Labour administration. They received cross-party support when put before Parliament. Whilst some individual members of Parliament objected that the privilege of limited liability should only be extended to shareholders in companies, it would be fair to say that the measures, and the policy behind them, were not controversial. Indeed the proposition that a member of an LLP should not be able to be an employee was an explicit part of the policy, having been originally advanced by Baroness Buscombe in the House of Lords debate on the Bill which became the 2000 Act: "we believe that the Bill should make clear that a member of an LLP will not be an employee of the LLP unless there is express agreement to that effect between the member and the LLP." (*HL Deb 09 December 1999 vol 607 c1424.*)

10. Over time, of course, LLPs became the preferred (though not universal) choice of the professional firm facing a decision as to how it should be constituted. LLPs also came to be utilised for a much wider variety of purposes than were originally anticipated.

11. The remuneration arrangements of members of LLPs also evolved over time, reflecting the fact that if an individual became a member of an LLP, they could be remunerated without suffering the burden of employer's National Insurance contributions. With the last Labour government choosing to increase employer's National Insurance substantially during its tenure, the financial incentive to do this grew over time. However, of course, any individual accepting LLP membership would not be an employee as a matter of law and so would forgo those statutory rights which would accrue to him as an employee. The LLP would also lose the right

to claim statutory sick pay or statutory maternity pay in respect of the individual should they become relevant.

12. It is fair to say that for a period after 2000 there were differences of opinions among advisers as to how far it was possible to push an individual LLP member's arrangements towards having the characteristics of employment and remain confident that an employment would not actually arise. However, HMRC's attitude became clear over time – it would not argue that an individual was an employee of an LLP if they were a member of that LLP. This stance was confirmed orally by representatives of HMRC to various of our member firms, and also in writing by HMRC to the Association of Partnership Practitioners.

13. In our view this background is very important in understanding the scale of the impact of the existing proposals, and our criticisms of them. We must emphasise: since 1997 it has been clear government policy, endorsed by governments of different parties, that there should be neutrality for income tax purposes as between LLPs and general partnerships. This policy has been confirmed by HMRC. No change was suggested until the announcement of the current measures.

14. It follows from this that making individuals members of LLPs on terms as to remuneration which may resemble those of an employee of equivalent seniority in a company is not of itself tax avoidance. It is misleading to talk pejoratively, as HMRC did in the 20 May 2013 policy document putting forward these proposals, of LLPs being used to "disguise" employment and so "avoid" employment taxes. Where our member firms adopted such structures they acted entirely in accordance with Government policy, openly promoted and endorsed by HMRC. There was no disguise; there was no avoidance.

15. It is also worth repeating that this is not a case where a tax benefit can be delivered without any commercial consequence. In becoming an LLP member rather than an employee, an individual may give rise to a tax benefit but also suffers a very real detriment in losing their statutory employment rights – indeed the leading case of *Tiffin v Lester Aldridge LLP* concerned an LLP member who tried to claim employment status in order to found an unfair dismissal claim. This is not a clever piece of tax structuring which delivers a tax benefit for no cost – it is a changing of the parties' legal relationship with very real non-tax consequences. The fact that the proposals would result in the tax cost of employment status arising without the attendant benefits is in our view an unfair result of the underlying policy.

16. It is of course open to any government to change policy and subject any given category of taxpayers to a less favourable tax regime. Indeed, the 20 May document contains a more honest statement of the position where it states that "The Government considers that the continuation of this favourable treatment for an individual who, but for the legislation, would otherwise be employed by the LLP is unfair to other taxpayers and can create avoidance opportunities." This is a change of policy: it is not a closing of loopholes.

17. We would accept that the 2000 legislation and subsequent HMRC practice could perhaps be criticised as failing to deliver the desired neutrality of income tax treatment between LLPs and partnerships, on the ground that it made it so hard to be an employee of an LLP that it actually put LLPs in an advantaged position. However, the current proposals demonstrably go further than treating as an employee for tax purposes an LLP member who would otherwise be an employee as a matter of general law and change the policy fundamentally in that they clearly and explicitly place the LLP at a positive disadvantage. We have genuine difficulties with a policy that treats as an employee a member of an LLP who in another form of partnership, would (as a matter of general law) be a partner and thus treats one form of

partnership (ie the LLP) differently from other forms of partnership, particularly in view of the policy rationale behind the creation of LLPs.

18. Many of the businesses affected are world-class professional services firms, whose value to the economy is incalculable. This value is direct, in that these successful businesses are highly profitable and wealth generative. They have international client bases, and so make a real contribution to the balance of payments. The benefit is also indirect, in that the presence of these businesses, in a diverse and thriving competitive market, provides the essential infrastructure to support the UK's world leading financial services industry.

Our recommendations

Our first recommendation is that the implementation of the proposals should be delayed until 2015.

19. These proposals are detailed. They remain the subject of consultation and extensive lobbying. They are also still relatively undeveloped in a number of areas: while draft legislation and guidance exists on the major points, a number of consequential impacts remain unclear and, as stated above, there are real concerns over HMRC's views on how the legislation should be applied. It would also in our view make sense to await the Office of Tax Simplification report on the taxation of partnerships in order that any reforms arising from that report can be implemented as part of a package with these changes.

20. As things stand the new rules will come into force on 6 April. However, the legislation giving effect to them will not receive Royal Assent until mid- to late-July, and will be subject to change throughout that period. Indeed we would hope it would change in some respects before enactment.

21. Businesses need to be given the opportunity to consider properly the application of this legislation to themselves and evaluate their response. A variety of legitimate responses are possible – some minimal, some very fundamental. A firm whose remuneration structure includes some salaried members may decide the best course of action is to do nothing and pay the National Insurance imposed by the new law. It may decide it is best to change its remuneration structures such that the current salaried members are remunerated on a different basis – however, that process will, in a large firm, be time consuming as it will likely require amendments to the firm's constitution. It may decide to change its policy on making up partners such that individuals are not given the title partner until they have satisfied the firm that they are ready to become full equity partners.

22. We would note that whilst it is unlikely to be an option for law firms, one possibility that many investment managers to whom this legislation will apply will be considering is moving to a corporate structure instead of an LLP. Due to the slow process of regulatory approvals, it would be impossible for an investment manager wishing to respond in this way to do so before 6 April.

23. These are all decisions of great importance to these businesses, and will involve (indeed are already involving) the commitment of large amounts of senior management time to the detriment of their core businesses. It is of course not improper for businesses to go through this thought process. It is not indicative of tax avoidance in any way. It is a perfectly legitimate examination of the changed choices offered by the tax legislation and a resulting consideration of the business' response to those choices.

24. The consultation process has also been managed in a regrettable manner. It is extremely unusual, as was the case here, for the second iteration of proposals to be more aggressive to taxpayers than the first. Additionally, during the early part of the consultation process, many of our member firms were told by representatives of HMRC that they should not worry about the proposals as HMRC was not looking to target professional firms. This message has now been reversed, and in similar discussions HMRC are now saying the opposite. This does not promote trust and confidence in the consultation process. It also emphasises the point on timing: law firms could not have reasonably anticipated that they would be targeted by these measures until the publication of the second iteration on 10 December 2013.

25. Requests for a deferral of the proposals to HMRC have been met by the response that the tax take from the measure has now been baked in to the government's 2014/15 fiscal projections, and so a delay is impossible. This further undermines the validity of the consultation process, since it also implies that a significant reduction in the scope of the measures could not be contemplated.

26. In promoting its international competitiveness the UK sets great store by its commitment to the rule of law and legal certainty. The manner of introduction of these measures undermines both to the detriment of some of the country's most successful businesses. Put simply, it is not fair to require businesses to consider their response to a fundamental policy change – and that is what these proposals are – without being able to see the law and all relevant supporting material in its final form. Doubly so where legitimate responses to the change will in many cases be substantial and time-consuming. Yet that is what is currently happening.

Our second recommendation is that the detail of the proposals be reviewed as their current scope exceeds that of the published policy and so does not give proper effect to it.

27. We will be making detailed technical recommendations to HMRC on these points. However, in our view the key points to be addressed are around the remuneration-based test of true partnership ("Condition A" in the draft legislation):

    - If individuals come together to try and maximise their collective profit in order to divide that profit amongst themselves, they have the economic character of partners rather than employees. It should not matter how that profit is divided up. A business is no less a partnership if it divides up its profits based on the recommendations of a remuneration committee considering individual performance than if it does so by reference to a pre-set formula based on set partnership shares. As drawn the legislation (certainly as interpreted by HMRC based on their Technical Note and Guidance) does not deliver this result.

    - Similarly HMRC contend that an individual may be a salaried member if he is remunerated by reference to the performance of part of a business rather than all of it (for example, in a multi-office firm, if they get a share of their office's profits rather than the profits of the entire firm). This cannot be right: if such an individual is not "really" a partner in the entire firm, then surely their position is far more akin to that of a partner in a smaller firm than that of an employee? On the flipside, especially in the context of overseas firms with UK offices, members of UK LLPs are often remunerated by reference to the profits of both the UK LLP and an overseas LLP. HMRC are contending that such an arrangement should be caught, whereas again the analogy should not be to an employment but to partnership in a different (in this case bigger) firm.

- Our view is that the legislation should not apply to any individual whose arrangements are such that what they get is a slice of the firm's total profits. It should not matter whether that slice is fixed or variable or, if variable, the basis of any variation. It also should not matter if some members' call on profits is senior to that of others. The defining feature of salaried member status should be whether an individual gets paid anyway even if profits are insufficient. An employee of a business has a contractual right to be paid. If the business has insufficient cash to do this it must raise that cash somehow or declare itself insolvent. An equity holder of a business knows that they only get paid if profits are sufficient, and has no right to claim payment if they are not. This is the economic distinction between an employee and a partner. Put in those terms it is easily drawn. The much more extensive terms of Condition A, as interpreted by HMRC, will catch many individuals who are in fact clearly equity holders in economic terms and not employees. The draft legislation does not deliver the policy objective.

- It follows from our reasoning above that we would accept that where a member of an LLP is entitled to a minimum (or fixed) guaranteed payment, such that other members will fund the payment in the event profits are insufficient, then that minimum or fixed amount should be treated as disguised salary within the current draft legislation.

- The targeted anti-avoidance rule is also drafted far too widely. In seeking to ignore for tax purposes all arrangements whose main purpose is to ensure that the new provisions do not apply, it calls into question whether HMRC would seek to disregard a genuine restructuring of arrangements in response to the new rules with the real commercial effect of turning members into what HMRC would accept were "true" partners. It cannot be correct for this to be the effect of the provision.

28. If these points were to be adequately addressed the importance of postponing the measures would of course diminish to some degree since it would follow that the number of businesses affected would be greatly reduced.

29. The City of London Law Society Revenue Law Committee[1] will also be making these policy points to HMRC directly in due course as part of the consultation process in addition to making detailed technical submissions on the draft legislation and Technical Note and Guidance.

Yours faithfully,

David Hobart
Chief Executive, City of London Law Society

[1] A list of the members of the CLLS Revenue Law Committee can be found here: http://www.citysolicitors.org.uk/index.php?option=com_content&view=category&id=156&Itemid=469