

# LIMITED LIABILITY PARTNERSHIPS ACT 2000

---

## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

#### *Introductory*

#### *Section 1: Limited liability partnerships*

*Subsections (1) to (3)* An LLP is a legal person in its own right. It is a body corporate, formed on incorporation (see section 3). It has unlimited capacity and will, therefore, be able to undertake the full range of business activities which a partnership could undertake.

*Subsection (4)* While in law an LLP is separate from its members, its members may be liable to contribute to its assets if it is wound up. The extent of that potential liability will be set out in regulations.

*Subsection (5)* As an LLP will be a body corporate, partnership law will not in general apply to an LLP. Elements of partnership law may, however, be applied to LLPs by regulations made under section 15(c), and section 5(1)(b) provides that regulations under section 15(c) will apply in the absence of agreement as to any matter concerning the mutual obligations of LLP members, or LLP members and the LLP.

#### *Incorporation*

#### *Section 2: Incorporation document etc*

Section 2 sets out the conditions which must be met for an LLP to be incorporated.

*Subsection (1)* To form an LLP, there must at the outset be at least two people who are associated for the carrying on of a lawful business with a view to profit and who subscribe their names to a document called an “incorporation document”. The incorporation document must be delivered to the registrar (defined in section 18). A statement must also be delivered to the registrar that there has been compliance with the requirement that at least two persons, associated for the purpose of carrying on a lawful business with a view to profit, have subscribed their names to the incorporation document. The statement must be made by a subscriber to the incorporation document or a solicitor engaged in the formation of the LLP.

*Subsection (2)* The incorporation document must contain various items of information: the name of the LLP, whether the registered office is to be situated in England and Wales, in Wales or in Scotland, the address of the registered office, the name and address of the persons who are to be members on incorporation and whether some or all of the members are to be designated members.

*Subsection (3)* An offence is committed if a person makes a statement under subsection (1)(c) that he knows to be false or does not believe to be true.

*Subsection (4)* Where a person is guilty of an offence under subsection (3) that person will be liable on summary conviction to imprisonment for no longer than six months

or a fine that does not exceed the statutory maximum (currently £5,000) or both. If the conviction is on indictment that person will be liable to imprisonment for a period of not more than two years or a fine or both.

### ***Section 3: Incorporation by registration***

*Subsection (1)* When the registrar receives the incorporation document he will retain and register it. Once the documents have been registered, the registrar will issue a certificate that the LLP is incorporated by the name specified in the incorporation document.

*Subsection (2)* A statement that is delivered under section 2(1)(c) may be accepted by the registrar as sufficient evidence that the requirement in section 2(1)(a) has been complied with.

*Subsection (4)* The certificate issued by the registrar is evidence that all requirements have been complied with.

## ***Membership***

### ***Section 4: Members***

*Subsection (1)* The first members of an LLP are those who signed the incorporation document.

*Subsection (2)* After incorporation, any person may become a member of an LLP by agreement with the existing members.

*Subsection (3)* A person may cease to be a member by death, dissolution and in accordance with any agreement with the other members of the LLP. Where there is no agreement a member may cease to be a member by giving reasonable notice to the other members.

*Subsection (4)* A member of an LLP will not be regarded as an employee of the entity, unless, if he and the other members were partners in a partnership, he would be regarded as an employee.

### ***Section 5: Relationship of members etc***

*Subsection (1)* deals with the relationship between members. The rights and duties of the members of an LLP to one another and to the LLP are governed by the provisions of any agreement between the members, subject to the provisions of any enactment. The Act does not require an agreement to be entered into between the members and there is no requirement to publish it (although, as noted in paragraph 17 above, there will be clear advantages in an LLP having a formal written agreement). In the case where there is no agreement on any matter the mutual rights and duties of the LLP and its members will be governed by default regulations made under section 15(c). The default regulations (see paragraph 12 above) will make provision concerning various matters, including the entitlement of members to share equally in the capital and profits of the business and that every member may take part in the management of the LLP

*Subsection (2)* provides that when an LLP comes into being it is bound by the terms of any agreement that is entered into by the subscribers to the incorporation document.

### ***Section 6: Members as agents***

*Subsection (1)* Each member of the LLP is an agent of the LLP. Each member may, therefore, represent and act on behalf of the LLP in all its business (subject to subsection (2)).

*Subsection (2)* An LLP is not, however, bound by the actions of a member where that member has no authority to act for the LLP, and the person dealing with the member

is aware of this or does not know or believe that the member was in fact a member of the LLP.

*Subsection (3)* Transactions with a person who is no longer a member of an LLP are still valid transactions with the LLP, unless the other party has been told that the person is no longer a member, or the registrar has received a notice to that effect.

*Subsection (4)* ensures that where a member of an LLP is liable to a person (other than another member of the LLP) for a wrongful act or omission in the course of business of the LLP or with its authority, the LLP will be liable to the same extent as the member.

### ***Section 7: Ex-members***

This concerns the situation where a person ceases to be a member of an LLP, or his interest in the LLP is transferred to another person. A former member, the member's personal representatives, the member's trustee in bankruptcy or liquidator or the trustees under the trust deed for the benefit of his creditors or assignee may not interfere with the management or administration of the LLP, but may receive any amount to which they are entitled.

### ***Section 8: Designated members***

In general, the role of designated members is to perform the administrative and filing duties of the LLP. However, some provisions of the Companies Act 1985 and the Insolvency Act 1986, as intended to be applied by regulations under the Act, will place on them tasks which go beyond the mere administrative and in the performance of which they would be representing all the members of the LLP, for example, the signing of the LLP's accounts.

*Subsection (1)* provides that, where the incorporation document specifies that certain members are to be the designated members, then they will be the designated members on incorporation. Other members may become designated members by agreement with the members. A member may cease to be a designated member by agreement with the other members.

*Subsection (2)* requires there to be at least two designated members and provides that if no members or only one are designated then all members are designated members.

*Subsection (3)* provides that if the incorporation document states that every person who is a member of the LLP is a designated member then all persons who are from time to time members are designated members.

*Subsection (4)* permits the LLP to notify the registrar that all members of the LLP are designated members or that specified members will be designated. Where the LLP notifies the registrar the effect will be as though it had been stated in the incorporation document.

*Subsection (6)* explains that when a person ceases to be member of the LLP he will also cease to be a designated member.

### ***Section 9: Registration of membership changes***

*Subsection (1)* provides that where a person becomes or ceases to be a member or a designated member the registrar must be notified within fourteen days and that a change in the name or address of a member must be notified within twenty eight days.

*Subsection (2)* states that where all the members of an LLP are designated members notification only needs to be given that a person has ceased to be a member and there needs to be no separate notification that they have ceased to be a designated member.

*Subsection (4)* provides that, where subsection (1) is not complied with, the LLP and all designated members commit an offence.

*Subsection (5)* explains that a defence to subsection (4) is available for designated members if they can prove that they took all reasonable steps to ensure that subsection (1) was complied with.

*Subsection (6)* explains that where a person is guilty of an offence under subsection (4) they would be liable on summary conviction to a fine not exceeding level 5 on the standard scale (currently £5,000).

## **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).

*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.

***Regulations***

***Section 14: Insolvency and winding up***

*Subsection (1)* The Secretary of State is required to make regulations applying or incorporating, with such modifications as appear appropriate, Parts I to IV, VI and VII of the Insolvency Act 1986.

The Insolvency Act provides a comprehensive code of procedures relating to both corporate and individual insolvency. This subsection ensures that the major corporate insolvency and winding up procedures including company voluntary arrangements, administration, receivership and voluntary and compulsory winding up, will be applied to LLPs. Such procedures will be adapted as necessary to suit LLPs.

*Subsection (2)* The Secretary of State may make regulations making other provision about the winding up and insolvency of an LLP or an overseas limited liability partnership by applying or incorporating with or without modifications, or disapplying, any law relating to the insolvency or winding up of companies or other corporations.

***Section 15: Application of company law etc***

Section 15 allows the Secretary of State to make regulations applying or incorporating the law relating to corporations, companies and partnerships (with appropriate modifications) to LLPs.

***Section 16: Consequential amendments***

This section allows for enactments, in particular those affecting companies, other corporations or partnerships, to be amended in consequence of the provisions in the Act or of any regulations which may be made under it.

***Section 17: General***

This section makes general provision about regulations under the Act, and in particular allows regulations to provide that failure to comply with their requirements is a criminal offence. The section provides which of the regulations require the affirmative resolution procedure and which the negative resolution procedure.

***Supplementary***

***Section 19: Commencement, extent and short title***

*Subsection (3)* is designed to enable the regulation-making functions relating to the process of winding up of a Scottish LLP to be exercised by Scottish Ministers.