charterhouse

TAX PLANNING THROUGH AN LLP STRUCTURE

1 Summary

1.1 Problem:

1.1.1 An individual (or group of individuals) own an asset/s which generate a significant level of income subject to higher or additional rates of income tax; and/or

1.1.2 Significant capital gains are inherent in the property portfolio or another class of asset ("the assets").

1.1.3 The individual wishes to operate their business through a more flexible structure and to mitigate their ongoing tax liabilities by choosing a different structure through which to operate their business.

1.1.4 Individuals would be willing to revise the structure through which they currently operate but for the dry tax charges that otherwise generally occur on a transfer of business assets to other structures.

1.2 Solution:

1.3 Transfer the assets into an Limited Liability Partnership ("LLP") and operate a business within this structure for a period of at least 18 months. During this period, the income generated by the business will still be subject to Income Tax but for any sums that might be allocated to a corporate member of the LLP

1.4 Following this period it could be proposed that the business is incorporated into a limited company. This can be achieved in a number of different ways to achieve different client objectives. The profits thereafter will be taxable within a corporate structure. The profits will now be subject to corporation tax rates (currently 20% reducing to 17% by 1 April 2020) as opposed to the more punitive income tax rates (currently up to 45%) previously suffered. Profits can then be managed as part of the overall tax planning for the individual client.

1.5 A further benefit of this structure (depending on the means of incorporation) is that the assets will benefit from an adjustment to their base cost when they are put into the corporate structure, the values at which the assets are carried in the corporate structure is the market value at which they were introduced to the LLP, as opposed to the CGT cost previously carried by the individual prior to disposal.

1.6 The transaction can be undertaken in such a manner as to allow the profits from the corporate structure to be drawn by the individual free of tax for a significant period of time.

1.7 It also facilitates future IHT planning which may be considered whereby individuals seek to pass assets to family members (not spouse) but are put off doing so by the immediate charge to CGT. Shares/debt in the structure can be gifted in such circumstances with no CGT charges arising. In certain circumstances, it may also be possible to structure the new company to take advantage of BPR on the transfer of these shares.

2 FAQ's

2.1 Who is it for?

2.1.1 The structure is suitable for anyone with a property portfolio or other asset(s) that generate substantial income. There may also be an additional benefit where there are latent gains within the assets.

2.2 What are the benefits?

2.2.1 The key benefit is a reduction in income tax rates from 45% to the much lower corporate tax rates currently 20% but which will reduce further following the recent budget announcement.

2.2.2 There will be no liability to SDLT for the transfers of real property or Stamp Duty where the asset is shares into the LLP nor should there be in respect of a subsequent transfer into a limited company or back to the individual.

2.2.3 There is an adjustment to the base cost of the asset carried by the Limited Company

2.3 What are the risks?

2.3.1 The risks in achieving the transition of the portfolio from the individual to the limited company are relatively low.

2.3.2 There is a risk that on a subsequent disposal of the assets or the shares in the company there will be a challenge by HMRC as to the whether there was an earlier disposal

2.3.3 There is a risk that HMRC seek to argue that the main purpose of the structure is for the avoidance of SDLT and/or stamp duty and that a charge arises.

2.3.4 There is a risk that the legislation at a time when the members of the LLP might consider incorporating the business has changed and the tax consequences of doing so differ from the position today.