Becoming a Partner

Congratulations on your recent promotion to partner. With all of the exciting changes that have been going on in your professional life, it is easy to overlook the impact on your personal affairs. To help you stay on top of these, we have put together a summary of some of the information you should be aware of.

Although an LLP is a separate legal entity, it is not taxed in the same way as a limited company. Individual partners in an LLP are taxed on their share of the profits and chargeable gains on disposal of partnership assets in the same way as a traditional partnership would, so it is important you have an understanding of how this affects you.

By now you will have received your P45 effective from the date of your appointment. This is because you are no longer an employee of the firm, but a self-employed Member. A step which is often overlooked is the requirement to notify HMRC of this change by registering as self-employed. Ideally you should do this as soon as possible, although you will not receive a penalty as long as you file your self assessment tax return and pay the amount due on time.

To do this you will need the Partnership's Unique Taxpayer Reference (UTR), which is a 10 digit code specific to the LLP. Your finance partner should be able to give you this. The process of registering is straightforward via an on-line application. In approximately 10 days HMRC will then send you an activation code for your account. It is important that you use this activation code before it expires (normally 14 days) otherwise you will have to apply for a new code.

The firm will continue to pay you a monthly amount. However, instead of being salary, these are payments on account of your expected profit entitlement for the year, known as drawings. Because these are not classed as salary they are paid gross of income tax, but critically they do not include any deductions for National Insurance Contributions (unless your firm withholds tax reserves on your behalf).

As an employee, the partnership will have deducted Class 1 national insurance from your salary. As a self-employed professional you have to pay Class 2 and 4 contributions.

For the 2017/18 tax year Class 2 contributions are a set amount of £2.85 for every week you are self-employed providing that you have taxable profits expected to be in excess of £6,025 for the year.

The amount of Class 4 contributions payable is calculated as a percentage of your taxable profits as follows:

Profits below £8,164	0%
Profits between £8,164 and £45,000	9%
Profits in excess of £45,000	2%

Both of these amounts are now included in your tax return and paid alongside your income tax liabilities.

The partnership profits you will be taxed on are set out in the Partnership tax return, which is prepared annually, and is normally prepared alongside the LLP's annual accounts. Once finalised you will be given a copy of your page from the partnership return to give to your accountant to form the basis of your self assessment tax return.

LLPs can draw up their accounts to any date in the tax year. For established businesses, tax is assessed on the profits of the accounting period ending in the tax year. For example, an LLP with a 30 April 2017 year end will include these profits in their 2017/18 tax return.

The profit per the accounts is the starting point for the calculation of taxable profits, which then needs to be adjusted for items such as depreciation, capital allowances and qualifying personal expenses.

The extent to which you can claim personal business expenditure will depend on the partnership's internal rules, but can include items such as use of home as office, travel and motor costs and other business expenditure. To be able to claim these they have to be included in the partnership tax return, and they act to reduce the taxable profit for the whole partnership.

Most people are aware that you have to pay your tax liability by 31 January each year. However, partners in LLPs usually have to make two payments to HMRC: 31 July and 31 January each year. These are payments on account of the anticipated tax due on your profits which will be earnt in the next tax year.

Worked Example

Your tax bill for the 2016/17 tax year is £3,500. You made 2 payments on account last year of £1,000 each (£2,000 in total).

The total tax to pay by midnight on 31 January 2018 is £3,250. This includes:

- your 'balancing payment' of £1,500 for the 2016/17 tax year (£3,500 minus £2,000)
- the first payment on account of £1,750 (half your 2016/17 tax bill) towards your 2017/18 tax bill

You have to pay your second payment on account of £1,750 by midnight on 31 July 2018.

If your tax bill for 2017/18 is more than £3,500 (the total of your 2 payments on account), you'll need to make a 'balancing payment' by 31 January 2019 alongside your next payment on account.

The taxable profits per the LLP tax computation are included in the self assessment return for the fiscal year in which the year end falls. So, if the LLP prepares a partnership tax computation for the year ended 30 April 2017, then the taxable profits arising will be included in your 2017/18 tax return.

Regardless of whether you are setting up your own practice, or are a member of an existing LLP there are additional rules regarding how the profits are taxed. In summary:

- The first year's tax is assessed on profits generated from the start of trading to the following 5 April.
- The second year's tax is assessed on:
  - The profits of the 12 months ending on the chosen accounting date in that tax year; or
  - The profits of the first 12 months of trading where the accounting date is less than 12 months after the start of the business; or
  - The profits of the tax year itself, where there is no accounting date ending in that year.

These rules mean that some of the initial profits are taxed twice, known as overlap profits. This is not reflected in the partnership tax return, but are adjustments made in the workings for each individual partner's self assessment return.

Worked example

You incorporate your LLP on 6 July 2016 and elect to prepare your accounts to 31 December 2017 and make a taxable profit of £250,000 per the partnership return for the 18 month period. This will be taxed as follows:

Year 1 (2016/17): profits generated in the period 06.07.16 – 05.04.17 = 9/18 x £250,000 = £125,000 profits subject to tax.

Year 2(2017/18): The profits on the 12 months ended 31.12.17 = 12/18 x £250,000 = £166,666.

Year 3 (2018/19): the profits for the year ended 31 December 2018 will be taxed.

Therefore the profits subject to tax in respect of the period ended 31 December 2017 is £125,000 + £166,666 = £291,666 meaning £41,666 of these profits have been taxed twice i.e. they have overlapped.

Generally speaking, when you resign as a partner (or retire) from the partnership then you will be able to deduct these overlap profits from your final taxable profits per the partnership return thus getting relief for this double taxation.

We hope you have found this introductory guide useful to ensure you keep your affairs in order. This is a general overview and is not a substitute for professional advice on your own personal situation. If you would like further guidance on any of the items mentioned above, or for a more detailed discussion as to how tax legislation applies to you in your new role, we would be happy to meet you to discuss your specific requirements.

About Kingston Smith's Professional Firms team

Kingston Smith's specialist Professional Firms team has a wealth of experience providing sound advice to architects, property agents, lawyers, patent attorneys and property & construction consultants. As a top 20 firm of Chartered Accountants with 60 partners in six UK offices, and a founding member of Morison KSi, we can meet your UK and international business needs.

City

John Staniforth
jstaniforth@ks.co.uk
T 020 7566 3644

Jon Dawson
jdawson@ks.co.uk
T 020 7566 3748

Heather Powell
hpowell@ks.co.uk
T 020 7566 3811

Jamie Sherman
jsherman@ks.co.uk
T 020 7566 3833

Becky Shields
bshields@ks.co.uk
T 020 7566 3634

Mark Twum-Ampofo
mtwum-ampofo@ks.co.uk
T 020 7566 3648

Heathrow

Jonathan Seymour
jseymour@ks.co.uk
T 020 8848 5531

Redhill

David Montgomery
dmontgomery@ks.co.uk
T 01737 779 000

Romford

Dan Martine
dmartine@ks.co.uk
T 01708 759 759

St Albans

Silvia Vitiello
svitiello@ks.co.uk
T 01727 896008

West End

John Staniforth
jstaniforth@ks.co.uk
T 020 7566 3644

Updated March 2017.
Views expressed in Kingston Smith LLP **Becoming a Partner** are those of the contributors. No responsibility for loss occasioned by any person acting or refraining from action as a result of the material in this publication can be accepted by the LLP or any of its associated concerns.