The Golden Rules of partnership law

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River Group – 9 June 2020

1: Thou shalt not confuse partnerships and LLPs

Structure

1890 Act partnerships

- Partnership is the relationship between at least two people carrying on a business in common with a view of profit: PA 1890, s 1.
- No separate legal entity. Third parties contract with the partners.
- Possible for partnership to arise although there has been no express agreement to create one.
- Partners can be corporates or individuals.

LLPs

- Hybrid between a traditional partnership and a company.
- LLP is a corporate – separate legal person. Third parties contract with the LLP.
- Requires "two or more persons associated for carrying on a lawful business with a view to profit" to subscribe their names to an incorporation document at Companies House: LLPA 2000, s 2(1).
- Members can be corporates or individuals.

Control

1890 Act partnerships

- Partnerships are controlled by the partners, guided by any partnership agreement.

LLPs

- LLPs are controlled by the members, guided by any LLP agreement.
- Not required by statute to hold particular meetings or make decisions using a particular procedure.
- Must have at least two designated members: many formal/compliance functions – e.g. must notify and disclose to the Registrar.

Confidentiality

1890 Act partnerships

- No requirement to publish agreement or accounts.

LLPs

- LLP agreement – confidential – does not have to be lodged at Companies House.
- Accounts and names of members on Register.

Profits, losses & liability

1890 Act partnerships

- Business must be carried on with a view to profit.
- Subject to contrary agreement, profits (and capital) will be shared equally: PA 1890, s 24(1).
- Partners have unlimited liability for firm's debts – creditors can look to personal assets.

LLPs

- Intention of founding members must be to make a profit: LLPA, s 2(1).
- Subject to contrary agreement, profits (and capital) will be shared equally: LLPR, r 7(1).
- LLP has unlimited liability.
- Liability of members limited to their capital contributions.
- Although this is subject to clawback of drawings in insolvency situation: IA 1986, s 214A.

Interests in the partnership

- Both partners and members have a ‘share’ in the LLP.
- Not the same as a share in a company.
- It is a bundle of rights and obligations, ascertained by reference to the agreement or, in the absence of agreement, the default rules:
  - financial – e.g. to share in profits, but not a direct interest in the LLP’s assets; and
  - governance/administrative rights and obligations – e.g. a right to vote on an expulsion; a right to be involved in the management of the LLP’s business.
- In LLPs, this doesn’t usually give a member direct interest in the LLP’s assets, which will be owned separately by the LLP, but it does give partners an inchoate right in the firm’s assets.

Transfer of interests

1890 Act partnerships

- A partner can't unilaterally transfer whole of share.
- Only the financial rights of a partner can be transferred: PA 1890, s 31.
- Unless the partners agree to allow participation in management etc.

LLPs

- As with partnerships, only financial rights can be transferred; assignee/personal representative/creditor/trustee in bankruptcy can't take part in management or administration of any business or affairs of the LLP: LLPA, s 7.
- Assignee etc can probably be permitted to participate in management/administration by agreement or can be admitted as a member.

Interests on departure

1890 Act partnerships

- Value departing partner receives for share usually governed by agreement.
- If no agreement, entitled to unpaid profits, return of capital contribution, surplus assets, loans and tax reserve.
- If share is retained by continuing partnership, entitled to elect between the profit made on their share and 5% interest: PA 1890, s 42.

LLPs

- Value departing member receives for share usually governed by agreement.
- If no agreement, probably don't get to keep any part of share; will vest in continuing members.
- In return members are probably only entitled to profits up to the date of departure. They may not even get their capital back.

Ending the business

1890 Act partnerships

- Can be dissolved: at end of fixed period (s 32); by notice of a partner unless contrary agreement (ss 26 & 32); by death/ bankruptcy of a member unless contrary agreement (s 33); automatically if the partnership becomes unlawful (s 34); by court on application (s 35).
- Winding up can be carried out informally by partners if solvent.

LLPs

- Winding up either a decision made by agreement or on court order.
- IA 1986 applies to LLPs.
- Winding up requires formality – cannot be done by the members alone.

2: Thou shalt not be a member and an employee

Why is there a conundrum?

- Logically one might think that an LLP is a separate legal entity so why shouldn't the LLP be able to employ its members (like a company can employ directors or shareholders)?

- BUT....Section 4(4) purports to set out how you decide if someone is a member or an employee and provides that:

  "A member of a limited liability partnership shall not be regarded for any purpose as employed by the limited liability partnership unless, if he and the other members were partners in a partnership, he would be regarded for that purpose as employed by the partnership".

But what does it mean?

- A partner can never be an employee (because the employment relationship is very different to the partnership relationship (see *Cowell v Quilter Goodison Co* [1989] IRLR 392) and he would be employing himself (see *Ellis v Joseph Ellis & Co* [1905] 1 KB 324)).
- Read literally, the first part of section 4(4) would therefore be stating that a member can never be an employee, but the second part would then be redundant.
- Further, given that an LLP has a separate corporate identity, until recently, most (including Ondra) assumed that it was possible to be both an employee and a member of an LLP.
- This seemed to be borne out by the judgments of Rimer LJ in *Tiffin v Lester Aldridge LLP* [2012] 1 WLR 1887 and, more particularly, Elias LJ in the Court of Appeal in *Clyde & Co LLP v Bates van Winkelhof* [2012] IRLR 992.

Lady Hale in *Clyde & Co LLP*

- Supreme Court gave judgment in *Bates van Winkelhof v Clyde & Co* [2014] 1 WLR 2047.

- In her judgment, Lady Hale disagreed with Rimer's approach to s 4(4), she stated that:

  "*All that it is saying is that, whatever the position would be were the LLP members to be partners in a traditional partnership, then that position is the same in an LLP. I would hold, therefore, that that is how s 4(4) is to be construed*".

Reinhard v Ondra LLP

- See *Reinhard v Ondra LLP* ([2016] 2 BCLC 571, [2015] EWHC 26 (Ch); [2015] EWHC 1869 (Ch)), Mr Justice Warren.
- 660 paragraphs! (539 in the first judgment)
- Warren J adopted this construction (said it was not obiter), found that this was what *Tiffin* actually said as well, and concluded that currently, under English law, it is not possible for someone to be both a member and an employee of an LLP.
- A similar view was reached in *Altus Group (UK) Ltd v Baker Tilly* [2015] EWHC 12 (Ch) at paras 161-3

What if the Agreement purports to give dual status?

- To be avoided if you can!
- Could not in law make someone both a member and employee so either:
  - A member with shadow employment;
  - An employee with shadow membership.
- “shadow” in the sense of putting the individual by contract (in so far as possible) into the same position as he would have been in he had held that status in law

What did Warren J conclude and how?

Warren J concluded that Mr Reinhard was a member in two ways:

- First, because the parties had at the time of entering into the contract objectively (mis)understood that it was possible to make someone both a member and an employee, he said that the appropriate construction was that which comes closest to achieving, in commercial terms, the result which would have ensued had it been possible for Mr Reinhard to be both an employee and a member. On the facts, he found that membership came closer to giving Mr Reinhard what the contract intended.
- Second, in case he should instead have construed the contract as if both parties understood you can only have one status, he carried out a careful analysis of all of the indicators in the contractual documents which pointed towards one status or the other. After weighing all the indicators in the balance, he found that the substance of the overall rights and obligations reflected a construction which gave Mr Reinhard membership.

3: Thou shalt not bring (most) employment tribunal claims

Thou shalt not bring (most) employment tribunal claims

Are we dealing with "employees" or "partners"?

- It is a question of substance rather than form. Indeed:
  - **The terms of a contract are not necessarily conclusive** – For example, in *Reinhard v Ondra* [2015] EWHC 1869 (Ch)), despite the 'employment' contract, the Court held C's entitlement to play a part in management and to share in the profits (including surplus on winding up) led to the conclusion C was a member despite not being registered.
  - **Registration as a Member (or lack of such) is not necessarily conclusive** - in *Polegoshko v Ibragimov* [2015] EWHC 1669 (Ch), the Court rectified the register of LLP members on the grounds it did not reflect the reality of the ownership of the LLP.
- **Salaried/fixed share partners?** In *Tiffin v Lester Aldridge LLP* [2012] EWCA Civ 35, the Court of Appeal confirmed that a *"fixed share partner"*, even one with very limited capital contribution and voting rights, did **not** have employee status and is not entitled to seek unfair dismissal if levered out of the business. Salaried partners may be employees – depends on true nature of the relationship (*Stekel v Ellice* [1973] 1 WLR) 191

Thou shalt not bring (most) employment tribunal claims

Employment associated rights

- Employees benefit from statutory protections, including:
  - Fair dismissal rights
  - Unfair Dismissal Rights
  - Redundancy Rights
  - Paid time off for public duties;
  - Statutory Sick Pay
  - Employer Insolvency Rights
  - Parental Leave
  - Non-discrimination per Equality Act 2010
  - TUPE Regulations

Thou shalt not bring (most) employment tribunal claims

Worker associated rights

- Whether a true LLP Member can be a *"worker"* for the purposes of other statutes will depend on the definition of *"worker"* in that legislation, and the particular facts of the case.
- Where statutory rights attach to *"worker"* status – for example: the protection of whistle blowers, National Minimum Wage ("**NMW**"), limitations on working time, right not to suffer detriment for exercising rights in respect of the NMW and/or working time regulations, paid annual leave, rest breaks, right to be accompanied at disciplinary/grievance hearing (and the right not to suffer detriment for so exercising rights), right to pensions contributions from employer under the auto-enrollment scheme, prohibitions on discrimination in relation to part time work, right not to suffer detriment for exercising trade union membership rights etc…
- *"Workers"* also benefit from the EA 2010 prohibition on discrimination

Thou shalt not bring (most) employment tribunal claims

Partner associated rights

- Members/Partners cannot rely upon 'employment' rights **but**, where they meet the definition of 'worker' they may be able to claim 'workers'' rights.
- Otherwise, a Member/Partner needs to look to the LLP/Partnership Agreement. For example, they might be able to claim for expulsion in breach of the power to do so in the LLP/Partnership Agreement
- Whilst there is no entitlement to redundancy pay, an outgoing Member/Partner is likely to have little to no difficulty in establishing entitlement to the profits prior to his leaving date and to the repayment of loans, although his/her entitlement to repayment of capital/surplus value will largely be governed by the LLP/Partnership Agreement
- Members are protected by non-discrimination – For example, they could claim discriminatory expulsion (e.g. *Train* [2009] All ER (D) 134)
- Automatic enrolment work place pensions can be excluded for LLP members (although not those taxed as employees)

4: Thou shalt not receive a salary

Profit share, not remuneration?

- Traditionally, partners and members do not receive remuneration for services (salary).
- They get a share of the profits as a reflection of their interest in the business.

The rule

A fiduciary who breaches their duties can lose their right to remuneration

- The rule may not apply where:
  - the breach was made honestly (i.e. innocently): see *Keppel v Wheeler* [1927] 1 KB 577 and *Kelly v Cooper* [1993] AC 205; or
  - in the court's view, it would not be proportionate and equitable to apply it: see *The Governor of the Bank of Ireland v Jaffery; Avrahami v Biran* [2012] EWHC 1377 (Ch).
- It may be that there will be an allowance made for skill and effort: see *Premium Real Estate Ltd v Stevens* [2009] 5 LRC 56 *; Gamatronic (UK) Ltd v Hamilton* [2016] EWHC 2225.

Hosking v Marathon Asset Management LLP - first instance (arbitration)

- The founding members of an investment management LLP fell out and one (H), gave notice to retire.
- During his notice period, he made a business plan and spoke to four LLP employees about leaving with him to set up a new business.
- An arbitrator found that this was a serious breach of his duties as agent to the LLP.
- H was ordered to pay equitable compensation to the LLP for loss of the chance of the LLP retaining the employees.
- **AND** H forfeit the part of his profit share which was said to be referable to his remuneration during his notice period.

Hosking v Marathon Asset Management LLP [2017] Ch 157 - on appeal

- The arbitrator's decision was upheld.
- Profit shares can be forfeit when they can be characterised as remuneration – substance over form. Newey J, at [43(i)]:

  "it is hard to see why the mere fact that someone is a partner or LLP member as well as an agent should preclude the operation of a principle which affects agents more generally. Supposing, therefore, that the arrangements relating to a partnership or LLP provided for a partner or LLP member to **receive a set sum for undertaking particular services regardless of the profitability of the firm or LLP, it would, in my view, be susceptible to forfeiture**" (emphasis added).

- Query whether this is legally correct.

Will this be a one off?

Newey J said, at [43(ii)]:

> it will often (typically, I suspect) be impossible to characterise all or any particular part of the profit share of a partner or LLP member as "remuneration".

But consider the import of:

- Partners/members working part-time for less profit share but same capital contribution;
- Reductions in profit share for sick leave/family leave.

May be a more regular occurrence than we expect.

What should you bear in mind?

- Is the partner/member a fiduciary?
- Has there been a breach of fiduciary duty?
- Does the partner/member receive “remuneration”?
- Was the breach honest?
- Would it, in the circumstances be proportionate and equitable to apply the forfeiture rule?
- Should forfeiture be limited, e.g., by time period or type of remuneration?
- Should the firm withhold profit share which is due? Or try to clawback payments made?
- Be careful not to waive the breach: see *Thornton Hall and Partners v Wembley Electrical Appliances Ltd* [1947] 2 All ER 630.

5: Thou shalt not repudiate thy contract

Repudiatory Breach – what is it?

What is repudiation in a contract?

- Two tests: (a) renunciation: evinces an intention not to perform, or (b) fundamental breach: goes to heart/root or frustrates the purpose of the contract.
- Contrast it with a non-repudiatory breach.
- So eg a delay in performance of a contract is not repudiatory unless the delay would frustrate the adventure.
- Look at all the circumstances objectively from the perspective of a reasonable person in the position of the innocent party, had the LLP/firm shown "an intention to abandon and altogether refuse to perform the contract"?
- *See Flanagan v Liontrust Investment Partners LLP* [2016] 1 BCLC 177 at [182-197].

The innocent party's position

- The innocent party is entitled to **elect** to:
  - treat the contract as no longer binding upon him/her and thereby he/she is discharged from **further performance** of the contract (albeit that rights which have already been unconditionally acquired are not divested or discharged); **or**
  - affirm the contract and seek damages for the breach.
- It is important to remember that the innocent party must accept the repudiatory conduct if the contract is to be terminated. If in the meanwhile he/she affirms the contract, then the right to accept what would have been a repudiatory breach is (irretrievably) lost.

Summary of the legal effect of repudiation in contract law

The legal effect of repudiation in a standard contractual situation is well summarised in *Photo Production v Securicor Ltd* [1980] AC 827, at 849F-G:

> "(a) there is substituted by implication of law for the primary obligations of the party in default which remain unperformed a secondary obligation to pay monetary compensation to the other party for the loss sustained by him in consequence of their non-performance in the future and (b) the unperformed primary obligations of that other party are discharged."

Repudiatory Breach – why does it matter?

Why might this matter?

- Contractual entitlements to future (but not past) performance falls away.
- Replaced by a claim for damages.
- With the future performance (both ways) falling away (probably) restrictive covenants, notice periods and in the LLP context the exclusion of s.994 Companies Act 2006 (unfair prejudice and buy out) also fall away.

Repudiatory Breach – what sort of conduct?

- *Lindley & Banks on Partnership* (20th ed), paragraph 24-13 talks about conduct which is of a *"fairly extreme nature, amounting to a denial of the partnership agreement or of the partnership itself"*.
- For the many years during which repudiatory breach of partnerships was assumed to apply to traditional partnerships, the type of conduct that one would talk about would be e.g.:
  - where partners purported to exclude one of their number without a power of expulsion;
  - placing a partner on garden leave without a power to do so;
  - exclusion from partner decision making;
  - or otherwise effectively treating that person as if he was no longer a partner.

  Flanagan v Liontrust Investment Partners LLP [2016] 1 BCLC 177 finds that exclusion from active participation in the LLP (the LLP having purportedly compulsorily retired and placed Mr Flanagan on garden leave, invalidly) would have been repudiatory breach had the doctrine applied.

Repudiatory Breach and traditional partnerships

- Can it be used to bring about the dissolution of the partnership itself?
- *Hurst v Bryk* [2002] 1 AC 185 (per Lord Millett) said "no"(albeit obiter dicta) because:
  - the nature of a partnership not merely contractual: it is a relationship; and
  - underlain by equitable principles (and the partners submit themselves to the court of equity); and
  - there is the statutory overlay of the PA 1890, especially section 35 which contains provisions for court dissolution.
- Lord Millett's analysis adopted and applied in *Mullins v Laughton* [2003] Ch 250 (per Neuberger J) and said to be correct by Court of Appeal in *Golstein v Bishop* [2014] Ch 455 (per Briggs LJ).

Repudiatory Breach and LLPs (1)

Why might the position be different from a traditional partnership (ie why might repudiation operate to bring to an end LLP agreements)?

- LLPA 2000 s 1(5) specifically says "….the law relating to partnerships does not apply to a limited liability partnership".
- an LLP is different to a partnership, a separate legal entity.
- the relationship between members is governed by agreement (s 5 LLP Act 2000) so why shouldn't the contractual principles of repudiation apply?
- not an equitable relationship.
- no equivalent of s 35 PA 1890 provisions re dissolution in the LLP context (although there is s 996 CA 2006 & s 122(1)(e) of IA 86).

Repudiatory Breach and LLPs (2)

However *Flanagan v Liontrust Investment Partners LLP* [2016] 1 BCLC 177 decides that:

> "there is no place for operation of the doctrine in relation to section 5 agreements, save perhaps where the LLP has only two members" (para 234)

and:

> "To conclude, I am satisfied for the reasons which I have given that the doctrine is implicitly excluded in relation to multi-party section 5 agreements. Whether the doctrine would also be excluded in the simple case where an LLP has only two members is not a question which arises in the present case, and I therefore leave it open. For present purposes, the important point is that Mr Flanagan's attempt to claim the benefit of the default rules fails at this stage. In particular, I can see no proper basis in law upon which he might be entitled to claim any pro rata share in the profits of the LLP" (para 243).

Appealed but not on this point.

A possible sting in the tail....

If repudiation did apply to LLPs, then remember before a member makes the decision to elect to accept the repudiation:

- a member's right to recoup capital when he ceases to be a member is probably a creature of contract.
- arguably, if there is repudiatory breach and the LLP agreement falls away, a member could struggle to recoup his/her capital, save by way of trying to wind up the LLP.

Many complications.....

Many complex questions remain:

- What is the position as regards two member LLPs (expressly not decided in *Flanagan*)?
- Is *Flanagan* rightly decided? Will the Court of Appeal decide otherwise one day for multi-member LLPs?
- For two member firms what terms apply if repudiatory breach does work?
- In a two member firm is it really repudiation?
- If so, then do you end up with different rules applying to different members?

6: Thou shalt potentially be liable to third parties

Thou shalt potentially be liable to third parties

Employees

	Employees
Relationship	The employee is the agent; the employer is the principal.
Agency	Agent acting on behalf of Principal
Wrongs	The employer will be held liable for the torts and other wrongs of its employees committed in the course of their employment on the normal principles of vicarious liability.
Debts	The employee is not prima facie for the debts of the employer
Liability	The employee is not prima facie liable to contribute on winding-up of the employer

Thou shalt potentially be liable to third parties

Traditional Partnerships

	Partners
Relationship	A partnership has no separate legal personality
Agency	s5-6 PA: The partner is agent for the other partners and the firm
Wrongs	s10/12 PA: Every partner is jointly and severally liable for any loss/damage arising from the wrongful acts/omissions of partners in the ordinary course of business or with the authority of the partners.
Debts	s17 PA: Every partner is jointly and severally liable for the debts and obligations of the partnership incurred during the period of membership.
Liability	Partners have unlimited liability for the debts and obligations of the firm.

Thou shalt potentially be liable to third parties

Limited Liability Partnerships

	Members
Relationship	s6(1) LLPA - The Member is the agent; the LLP is the Principal
Agency	s6(1) LLPA confirms every Member is to be taken by third parties to be agent of the LLP (but not the other Members). This is qualified by s6(2) which provides an LLP is not bound where **both**: a) The Member has no authority; **and** b) The third party is aware that the Member has no authority, or did not know/believe the Member was an LLP Member (this includes actual knowledge and 'blind-eye knowledge')
Wrongs	s6(4) - the LLP can be vicarious liability for wrongful acts or omissions of Members committed in the course of the business of the LLP.
Debts	As agent, Members are generally not liable for the debts of the LLP.
Liability	s1(4) - The liability of a Member for the debts and liabilities of the LLP is generally limited to the sum (if any) (s)he has agreed with other members or with the LLP that (s)he will contribute on a winding-up.

7: Thou shalt not remove a partner unless there is an agreement

You need the power!

- We are not in the world of employment law and employment statutes... no constructive dismissal, unfair dismissal etc (albeit that members are usually workers with the protections that follow, whistleblowing etc)...
- In the partnership world it's all about the power!
- Cannot expel or compulsorily retire without an express power in the partnership or LLP agreement to do so (see s 25 PA 1890 and LLP Regulations 2001 Regulation 8 and *Eaton v Caulfield & others* (2011) BCC 386).
- Must actually be agreed (nb beware drunken train journeys!)
- A matter of analysing what happened....

What type of agreed clauses?

- Expulsion cf compulsory retirement of partners or members (nb not employees - the position is very different for employees).
- Establish first whether you are dealing with a partner/member or an employee (nb you cannot be a partner and an employee (see *Cowell v Quilter Goodison Co* [1989] IRLR 392 (CA)), nor a member and an employee: see *Reinhard v Ondra LLP* [2016] 2 BCLC 571(Ch) and *Bates van Winkelhof v Clyde & Co LLP* [2014] 1 W.L.R. 2047).
- Distinguish between:
  - a power to terminate for cause (usually called 'a power of expulsion')
  - a power to terminate without cause, but simply on the expiry of a given period of notice (usually called 'compulsory retirement'); usually the service of such a notice needs to be approved in advance by a given majority of members (often 75% or more).

What if there is no power?

- If there is no power then choices are limited.
- Try and negotiate a deal with the partner or member who the firm want to part company with.
- If no deal can be done then dissolution (for a partnership) or winding up (for an LLP) may be the only option, BUT this is not to be undertaken lightly. You cannot just re-form without the individual. A full account is needed and there are huge potential consequences/complications (regulation, insurance, staff, bank loans/guarantees called, client retainers etc).

Construing the clause

- Both an expulsion clause and a compulsory retirement clause are seen as expropriatory.
- The Court will approach the clause strictly and, in so far as there is an ambiguity, it will be construed against the person(s) seeking to exercise the power (see *Tim Ludwig Professional Corp v BDO Canada LLP* 2017 ONCA 292 at 33 and *Joseph v Deloitte NSE LLP* [2019] EWHC 3354 (QB)).
- But there are sensible limits to the strictness (see *Hitchman v Crouch Butler Savage Associates* (1983) 127 SJ 441).

Attacking an expulsion or compulsory retirement

Essentially one can attack an expulsion or compulsory retirement on these bases:

- the ground is not made out (in the case of expulsion alone); or

For ***both*** expulsion and compulsory retirement:

- the proper procedure was not followed (natural justice?); or
- discrimination (see especially the Equality Act 2010) [nb s 44 (partnerships) s 45 (LLPs)]; or
- the expulsion or compulsory retirement is vitiated by bad faith or ulterior/improper motive; or
- perhaps following *Braganza* the two *Wednesbury* limbs?

8: Thou shalt be subject to more stringent restrictive covenants

Restrictive covenants

Restrictive covenants only enforceable if the party seeking to enforce it can show:

- It has a legitimate interest capable of protection;
- The restraint is reasonable as between the parties in that it "affords no more than adequate protection to the party in whose favour it is imposed".

Theoretically, it also has to be reasonable as regards the public interest.

Employees

The covenant needs to do no more than restrict use by employee of:

> *such personal knowledge of and influence over the customers of his employer, or such an acquaintance with his employer's trade secrets as would enable him, if competition were allowed, to take advantage of his employer's trade connection or utilise information confidentially obtained*: *Herbert Morris Ltd v Saxelby*, *ibid*, at 709, per Lord Parker.

For example, often can't prevent employees from dealing with all clients of a firm - only those with whom they previously dealt with.

1890 Act partners

Wider restrictive covenants generally allowed because:

- partners have an interest in the underlying business so are treated like vendors selling goodwill;
- there is generally mutuality between the partners in terms of the covenants
- there is theoretically equality of bargaining power as between partners.

Classic partnership restrictive covenant case: *Bridge v Deacons* [1984] AC 705:

- Five year covenant, covering all of Hong Kong and preventing trade with any client of firm over last 3 years, found to be enforceable.

Members of LLPS

Arguments could be made that members of LLPs should be treated more like employees:

- most LLPs don't buy or sell goodwill when a member leaves;
- the LLP itself isn't bound by restrictive covenants so there isn't the same sort of mutuality.

However, the general assumption is that they will be treated in the same way as 1890 Act partners and can be bound by harsher restrictions (see, albeit only at an 'is it sufficiently arguable' level *PwC v Carmichael* [2019] EWHC 824 (Comm))

9: Thou shalt pay thine own tax

Thou shalt pay thine own tax [please check for recent changes]

Employment	Partnerships & LLPs*
How are they taxed?	
The employee will pay income tax and NIC on their earnings received from the employer	The Partner/Member will pay income tax and NIC on their share of the taxable profits received
What rates are annual earnings taxed at?	
Personal Allowance of £12,500 20% between £12,500–£37,500 40% between £37,501–£150,000 45% above £150,000	The Partner/Member's profits will be taxed on those applicable to it: either income for the self-employed or corporation tax for corporate partners. See later slides for mixed partnerships.
National Insurance Contributions?	
An employee pays Class 1 NIC	Partners/Members pay Class 2+4 NIC
How is tax paid?	
Employees will have tax deducted at source pursuant to the PAYE system	Partners/Members file self-assessment tax returns and make 'Payments on Account' twice per year

* Where an LLP carries on a *"trade (profession) or business"* with *"a view to profit"*, all the activities of the LLP are generally treated as being carried on in partnership by its members and not by the LLP as a separate entity (s 1273, CTA 2009 for corporation tax; s 863 ITTOIA 2005 for income tax and PM50510).

Thou shalt pay thine own tax

- An individual member ("**M**") will be treated as an employee if, in broad terms:
  - **Condition A - Disguised Salary**

    This is generally met if M performs services for the LLP as a member, and it is *"reasonable to expect"* that the remuneration for those services will be wholly, or substantially wholly (assumed to be 80% or more), *"disguised salary"* (being remuneration that is either fixed or, if it is variable, it is not calculated by reference to/affected by the overall profits or losses of the LLP)
  - **Condition B – Significant Influence**

    This is met if M does not have significant influence over the LLP's affairs.
  - **Condition C – Capital Contribution**

    This is generally met if M's capital is less than 25% of the disguised salary from the LLP in the tax year concerned.
- If any one of these conditions is not met, M will continue to be treated as self-employed for tax purposes and will be taxable on their share of the income and expenses arising in the partnership.

Thou shalt pay thine own tax

- Individual Members/Partners will have their share of the profits calculated per income tax rules. Corporate Members/Partners will have their share of the profits calculated per corporation tax rules.
- **Except** where 'mixed membership' rules apply – These aim to prevent (for example) profits being shifted from an individual to a corporate member/partner which he (or a member of his family) owns.
- In broad terms, the rules bite when an individual has a partnership profit arise for a period and *"it is reasonable to suppose that"* either:
  - Amounts representing his *"deferred profit"* are included in the profit share of a corporate member, and both his profit share and the tax he would pay are reduced as a result; or
  - The profit share of the corporate partner is greater than the *"appropriate notional profit",* and the individual has the *"power to enjoy"* the corporate partner's profit share (and his own profit share and tax are lower as a result).

Thou shalt pay thine own tax

- A LLP has five equal Members: B Limited, C, D, E and F.
- B Limited is owned by C's spouse. B Limited only provided funding of £1 million to A LLP and no other services, assets or facilities.
- Assume a similar third party loan would have a commercial rate of interest of 10% per annum.
- A LLP makes a taxable profit of £2.5 million.
- £500,000 of the profits is allocated to B Limited.
- Due to C's spouse's 'power to enjoy' B Limited's profits, the profits will need to be reallocated for tax purposes, such that B Limited's taxable profit is reduced to £100,000 – being 10% of £1 million. The balance of £400,000 is reallocated for tax purposes to the owner of B Limited – C and C's spouse – who have the 'power to enjoy' the profits of the company.

10: Thou shalt love thy fellow partner

A lot of love in a traditional partnership

- In a traditional partnership you really have to love (and trust) your fellow partner....
- A fiduciary relationship (see *Helmore v Smith* (1886) 35 ChD 436).
- Arises from partners being agents of each other (section 5 of the Partnership Act 1890).
- As a fiduciary, the duties a partner owes his fellow partners include:
  - good faith
  - honesty
  - duty to account
  - not to benefit yourself at the expense of your co-partners

A different kind of love in an LLP?

- In an LLP you usually love *the LLP* more than you love your fellow members....
- Remember LLPA 2000 s.6(1): "every member of a limited liability partnership is the agent of the limited liability partnership". The key relationship between LLP and member is one of agency, BUT...
- A member is not acting as an agent for all purposes.
- If a member is acting as agent he owes his principal fiduciary duties.
- Otherwise apply the key test that emerges from *F&C Alternative Investments (Holdings) Ltd v Barthelemy* [2012] Ch 613 at para 212:

  "Fiduciary obligations arise from particular circumstances, where a person assumes responsibility for the management of another's property or affairs" *White v Jones* [1995] 2 AC 207, at 271D-G.

Member owing duty of good faith?

Unlike for a traditional partnership in an LLP there is:

- No duty of good faith owed automatically between members.
- No duty of good faith owed automatically by the members to the LLP [See the decision of Sales J in *F&C Alternative Investments (Holdings) Ltd v Barthelemy* [2012] Ch 613 (at paras 207-216)].
- Often a duty of good faith is expressly included in the LLP agreement – usually owed to the LLP only.
- If it's an express term, that is a contractual not fiduciary duty.

What might amount to breaches of fiduciary duty?

The type of breaches that might amount to a breach of fiduciary duty could include for example:

- Orchestrating a team move (as in *Hosking*).
- Making a personal undeclared profit from his position.
- Diverting business opportunities from the firm to himself personally.
- Setting up a competing business.
- Misusing confidential information to personal financial advantage.

Love in the partnership and LLP world....

- In the traditional partnership model, it was all about doing unto others as you would have done unto you, trusting your fellow partners and sitting around the partnership table making decisions....
- In the world of LLPs, firms are often run in much more of a corporate way (the US firm and the bottom 5%!).
- Often these are very large businesses, run by a management board.
- Loving by TV screen?!

The Golden Rules of partnership law

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