

IFS Residential Conference 6 September 2014

Taxing Remuneration: principles
and practice



TRIVERS SMITH LLP

Simon Yates

Travers Smith LLP

The problem

It is very difficult to define an employee or employment-related income

Possible Solution 1

- Make the distinction much less important

Possible Solution 2

- Try anyway
-

Where should the system draw lines?

- Categorically not between UK LLPs and overseas LLPs trading in the UK: this is a very serious policy failure within the salaried members rules
- Arguably one might impose greater burdens on LLP members than general partners due to the privilege of limited liability, but if this is the policy, it should apply to all LLP members
- No real difference between small LLP and small company with few shareholders, so aspiration should be to deliver equivalent total tax cost

Defining an employee: *Tiffin* and the salaried members rules

- *Tiffin* sets the bar for employment high, probably due to court having little sympathy with claimant
- Salaried members rules build on *Tiffin* principles, but make it easier to be treated as an employee
- Three tests:
 - highly profit-related remuneration
 - significant influence
 - meaningful capital investment

How best to test for employment status?

- The three tests adopted are not strong indications of one status or another:
 - a banker in a division with a bonus pool will have highly profit-based remuneration yet be an employee
 - many employees have significant influence (most obviously senior management)
 - many employees have significant capital invested in their employers: it has long been government policy to promote employee share ownership
 - how to apply the capital test to businesses that need little capital?
Serious flaw of the salaried members rules is that they incentivise the pointless over-capitalisation of businesses

Equity return vs fruits of labour

Proposition: the factor that distinguishes employment income from equity return is enforceability. Equity return is by its nature subordinated to salary payments as it is to other liabilities; it is what is left over (which may be nothing)

So...

- if you can prove in a liquidation for your remuneration, that remuneration is employment income
- if you can enforce the right to be paid remuneration against another party on a liquidation (e.g. where equity partners guarantee junior partners' minimum drawings), that remuneration is employment income

But...

- if you do not get paid if there are no profits, the remuneration is not employment income