

AGREEMENTS

LLP Members' Agreements

Setting out profit allocation, capital, decision-making, retirement and expulsion so members aren't left with the statutory default provisions.

A body corporate run by contract

A limited liability partnership is a separate legal person, formed by registration at Companies House. Its members have limited liability, unlike partners in a general partnership. But unlike a company, an LLP has no articles of association. Its internal affairs are governed by the members' agreement, and where there is none, or it is silent, by default rules set out in regulations (the Limited Liability Partnerships Regulations 2001).

Many LLPs are formed with no written agreement at all. The default rules are then likely to surprise the members.

What the default rules provide

Subject to any agreement, in outline:

- members share capital and profits equally
- no member is entitled to be paid for acting in the business
- every member may take part in management
- ordinary matters are decided by a majority, but a change in the nature of the business needs everyone's consent
- a new member can be admitted only with the agreement of all existing members
- there is no power to expel a member unless the agreement gives one

These rules are even-handed and workable for a small group who contribute equally. They fit badly where members have unequal roles, capital or earning power.

Designated members

Every LLP must have at least two designated members. They carry the filing and compliance duties, such as delivering accounts and the confirmation statement and keeping the register of members. The agreement should say who they are, whether they receive extra reward, and what happens if one leaves, because the LLP must always have two.

Why it is worth doing early

Members usually think about the agreement when something has gone wrong. It is far easier to agree how profit is shared, and what happens if someone leaves, while all the members are on good terms and none yet knows who will gain or lose. A short agreement signed at the start is worth more than a long one drafted during a dispute.

Key points

- An LLP has no articles. The members' agreement is its rulebook.
- Defaults divide profits equally and give no right to expel a member.
- At least two designated members must be in place at all times.
- Members are not employees by default. Tax and employment status need care.
- The agreement is private and does not need to be filed.
- Review it whenever members join or leave.

What the agreement should settle

- **Profit allocation.** Fixed shares, a formula, or a points system. Say how profits are measured, how often the split is reviewed, and who decides.
- **Capital and drawings.** Each member's contribution, whether it earns interest, how drawings are set, and how tax on each member's share is funded.
- **Decision-making.** Which decisions need a simple majority, which need a higher percentage, and which need unanimity. Say how meetings are called and what counts as a quorum.
- **Authority.** Spending limits for individual members, and which contracts need a second signature.
- **Admission.** How new members are brought in, what they pay, and whether existing members have a right of first refusal.
- **Retirement.** Notice periods, how the member's capital and any share of undrawn profit are paid out, and over what period.
- **Expulsion.** The grounds, such as serious breach or loss of a professional qualification, and the procedure.
- **Death, incapacity and bankruptcy.** Whether the LLP continues, and what is paid to the member or their estate.
- **Restrictive covenants and confidentiality.** Reasonable limits that apply after a member leaves.

Before you start

- Who are the members and the designated members?
- How is profit divided, and how often is it reviewed?
- What decisions need more than a majority?
- How is a departing member valued?
- On what grounds can a member be expelled?
- Does any member hold a licence or qualification that the LLP depends on?

Tax and status

LLP members are generally taxed as self-employed on their share of profit. Some individuals who are treated as members may be taxed as employees under special rules. That treatment depends on the facts, so it should be reviewed with the members' tax adviser when the agreement is drafted.

Winding up and conversion

The agreement should deal with how the LLP is wound up. If the members later want to move to a company or a different structure, the agreement should say what vote is needed.

Keeping Companies House up to date

The LLP must tell Companies House of changes in membership and in the designated members, usually within 14 days. The register of members and the register of people with significant control must also be kept up to date. A members' agreement should say who is responsible for these filings, so they are not missed when a member leaves.

How MTM can help

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We prepare LLP members' agreements for practices and their clients, including for new LLPs we incorporate. We draft the agreement from your instructions, update it when members change, and make the Companies House filings for the LLP, including member and designated member changes. Tax advice on how members are taxed stays with you.