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Chartered Accountants and Business Advisors

Practicalities of forming a partnership

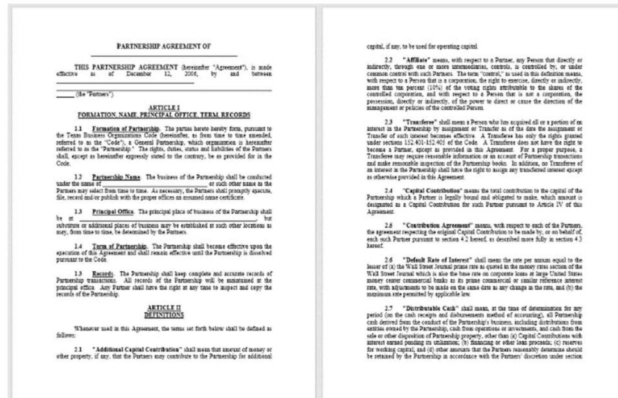
Introduction

Although a partnership can be a simple and flexible way for two or more people to own and run a business, unlike limited company status, partners do not have any protection if the partnership fails. If one of the partners resigns, dies, or goes bankrupt, the partnership has to be dissolved, even though the business itself may not need to cease.

If there is no formal Partnership agreement, to resolve disputes, this will be done with reference to the provisions contained within Partnership Act 1890. Reliance on this Act could result in unintended consequences for the partners and partnership in division of assets and income.

The Partnership Agreement

Although there are no legal formalities involved in establishing a partnership, and a partnership may come into existence under an oral agreement, it is advisable that a formal partnership deed is drawn up. This is a legal document that sets out what each partner is responsible for and what they can expect from the business. Many partnerships ask a solicitor to help with the deed, but it is possible for the partners to drawn one up themselves. Note that although anyone can enter into a partnership, partners under the age of 18 cannot be legally bound by the terms of a partnership agreement.



With regards to tax and National Insurance Contributions (NICs), each partner is self-employed and takes a share of the profits. Usually, the partners share the decision-making and management of the business, but each partner is personally responsible for any (and potentially all) debts that the partnership incurs, and each person pays income tax and NICs on his share of the partnership profits.

As well as an active partner (or partners), a partnership may include a sleeping partner. Broadly, the sleeping partner contributes money to the business but doesn't get involved in running it. This partner usually receives a smaller annual share of the partnership profits.

A partnership must appoint one of the partners (referred to as the 'nominated officer') to complete a partnership tax return each year and submit it to HMRC. This return includes a Partnership Statement, which shows how profits or losses have been divided amongst the partners. The nominated partner is also obliged to provide each partner with a copy of the Partnership Statement to assist them with completing their own personal tax return correctly.

Registration

All partners will be responsible for submitting their own individual tax returns. However, the partnership must register with HMRC by 5 October in the business's second tax year, or a penalty may be incurred. Registration should generally be done online although it can be done manually using form SA400 (for the partnership) and forms SA401(for the partners).

VAT

Where a sole trader takes in one or more partners there is a change in business entity for VAT purposes. If the sole trader is VAT registered, the change must be notified to HMRC within 30 days and the existing VAT registration will be cancelled. Alternatively, an application may be made (on form VAT 68) for the VAT registration to be transferred to the partnership. The partnership itself must register if the VAT taxable turnover is more than the VAT registration threshold (currently £85,000).

LLPs

A limited liability partnership (LLP) structure may be an agreeable compromise in some circumstances – offering both the flexibility of a general partnership and the limited liability protection of a company. LLP partners share costs, risks, and responsibilities of the business. They also take a share of the profits and pay income tax and NICs on their share of the partnership profits. However, under an LLP agreement, debt will be limited to the amount of money each partner invested in the business and to any personal guarantees given to raise business finance. Since liability is generally restricted to the level of investment, members of LLPs will benefit from a certain level of protection if the business runs into difficulties.

Recommendation

While it will seem to be a formal and sometimes costly exercise when starting a business. If there is a dispute or the circumstances of the partnership/partners change in the future, it will repay the investment. This is because it will provide a transparent and agreed process to deal with the challenges leading to a straight forward resolution. However, it is important to take legal advice in drawing up this legal document.

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