A GUIDE TO SETTING UP A BUSINESS AS A PARTNERSHIP
No. 28
April 2008 (Amended May 2009)

Introduction

Partnerships are a relatively simple way for two or more people to set up in business, having fewer administrative burdens than setting up and running a limited company. This factsheet looks at some of the advantages and disadvantages of this type of business, and reviews the main issues you will need to consider when setting up a partnership. It also looks at the Deed of Partnership, relevant regulations, tax, National Insurance (NI) and limited liability.

BIF 32 Choosing the Right Legal Status for your Business gives a brief overview of issues applying to partnerships, sole traders and limited companies. You will find this useful if you are weighing up which is the best option for your business.

Choosing to operate as a partnership

A partnership is a good legal status to consider if your business will involve two or more people owning it together. Like a sole trader, a partnership has no separate legal identity and does not need to be registered with Companies House. The partners will be regarded as self-employed.

Partnerships cannot normally have more than 20 partners unless they are for professionals such as accountants and solicitors. However, they are allowed to employ staff who are not partners in the business.

Management of a partnership is normally shared between the partners, but this can be varied by agreement. For example, a 'sleeping' partner is allowed to contribute some of the capital, without getting involved in the day-to-day running of the business.

Like sole traders, business partners have unlimited liability for the debts of the business, and are regarded as being liable, both jointly and severally. This means that all the partners are responsible for transactions or contracts entered into by any one or more of the other partners. However, if you are looking for a business status that would provide some protection from this risk, it is also possible to set up as a limited partnership or limited liability partnership (see BIF 365 A Guide to Setting up a Business as a Limited Liability Partnership).

How to set up a partnership

There is no requirement to register a partnership business with Companies House before you start trading, but make sure that:

- You draw up a Deed of Partnership with a solicitor, to set out the terms and conditions of the partnership. This will clarify each partner's legal position and provides a framework for dealing with any problems that arise.

- Each partner informs HM Revenue & Customs (HMRC) that they are starting in business. This must be done within three months of starting up to ensure that you are registered as self-employed. Penalties can be incurred if you do not register within this time.

- All letterheads, business cards and other business stationery disclose the trading name of the business (and the names of each of the partners, if these differ from the business' name).

- The partnership has the necessary licences and local authority permission. Businesses such as public houses, restaurants, private hire drivers and childminders require licences before they can start trading.

What is in a Deed of Partnership?

A Deed of Partnership is a document that details the terms and conditions covering the agreement between partners. Ideally, this should be prepared by a solicitor. If a Deed is not agreed, the partnership is governed by the terms of the Partnership Act 1890. However, the terms of the Act may not suit your circumstances. The Deed must include:

- The business name and names of partners.

- The nature of the business.

- The start date of the partnership (this may be before or after the date when the Deed is signed) and the duration of the partnership (the partnership could be set up for a fixed period of time with the option to renew it).

- The place where the partnership's business is carried out, and the names of the owners or the leaseholders.

- The terms on which the capital is contributed (how much from whom) and profits are shared (who gets how much). This could also include provisions for changing the proportions in future, or of any payments to partners before profit is shared.

- How the accounts will be kept, when they will be prepared and how they will be audited.

- Details of banking arrangements, such as the name of the business' bankers and the names of partners who will sign cheques.

- Insurance provisions and details of who will pay the premiums (the partners or the business).

- Working arrangements, such as the amount of time that each partner is expected to devote to the partnership.

- Provisions for the expulsion of partners. This should include measures to deal with a serious breach of the partnership agreement or bankruptcy.

The Deed should also include provisions for changes to the partnership, such as:

- Will any partner be entitled to nominate a new partner, or to assign, sell or leave their share in the partnership to someone else?

- Will retirement be compulsory on reaching a specified age or if the partner becomes ill or is injured?

- On the death, retirement or expulsion of a partner, will their share of the business be transferred to the other partners or will the partnership be dissolved?

What name can your business use?

A partnership can trade under the names of the partners - Smith and Jones, for example - or it can use a different name, like Hungry Café. If you choose the latter option, however, make sure that all business stationery displays the trading name as well as the partners' names.

If there are more than 20 partners, their names do not have to be listed on business documents. However, you must supply the address of the principal place of business from which a list of all partners' names can be obtained. It is not possible to list some of the partners' names without the others - it must be all or none.

If the business trades under a name other than that of the partners, and the name contains certain words, it may require the written approval of the Secretary of State. Controlled names are set out in statutory regulations. For more information about potential business names and specially controlled names, you should contact Companies House (www.companieshouse.gov.uk).

Who do you need to tell?

As soon as the business starts trading, you must inform HMRC. Partners are individually regarded as self-employed and so are responsible for paying their own income tax and NI contributions.

If you fail to register with HMRC within three months of becoming a partner in a business, you will be liable for a penalty of £100. The partnership may also face additional penalties for trading illegally and not paying tax.

HMRC will provide all the information you need about when and how to pay tax and NI. This information is also available on its website at www.hmrc.gov.uk, including the information pack 'Are you thinking of working for yourself?' (SE1), which contains form CFW1 for registering as self-employed.

If the partnership's annual turnover reaches a certain level (£68,000 for 2009/10), it will also be required to register for VAT. You may, however, register the business voluntarily if its turnover is lower than this threshold. This can have advantages, such as allowing your business to claim back VAT on purchases. More details are available from HMRC.

What are the tax implications of setting up as a partnership?

Income tax

As a member of a partnership, you will be taxed as a self-employed person. All partners are required to fill in tax returns under the self-assessment return scheme. You will have to fill in details of all sources of income, tax allowances, relief and gains.

If you wish to file a paper tax return or would like HMRC to calculate tax payments for you, your tax form must be returned by 31 October. If you calculate your own tax return and wish to file it online you have until 31 January to return the form. Through the self-assessment tax scheme, income tax is paid in two instalments during the year (on 31 January and 31 July). In addition to each individual return, a nominated partner must complete a partnership return that details the allocation of profits for each trading year.

National Insurance contributions

Each partner will pay Class 2, and may also have to pay Class 4, NI contributions. Class 2 contributions are flat-rate payments made on a weekly basis. If the earnings from the business are very low (below £5,075 for the financial year 2009/10) you may be entitled to make an application for a Small Earnings Exemption from NI contributions.

Once profits reach a certain level, each partner will also be liable to pay Class 4 NI. The self-assessment tax return will be used to calculate these contributions, which are worked out as a percentage of your share of the profit (8% for each partner's earnings between £5,715 and £43,875 in 2009/10).

After the first year of trading, partners will be required to pay the majority of their tax and Class 4 NI contributions in advance - payments will be calculated on your share of the previous year's profits. Payments may be reduced if profit levels are lower than expected.

Advantages of operating as a partnership

- Partnerships are not obliged to have the business' accounts audited or made public. However, individual partners will need to submit their own self-assessment tax return to HMRC, as well as a partnership return that must be completed by a nominated partner. Partnerships are not required to submit accounts to Companies House.
- Management responsibilities and financial risks are shared, so the business is not on one person's shoulders. Partners can also bring a range of different skills and experience to the business, making it less dependent on the resources of just one person.
- Raising capital is easier for a partnership business than for a sole trader because there is more than one person to contribute.
- The structure of a partnership can be flexible, depending on the terms laid out in the deed of partnership.
- There is less documentation to complete relating to legislation and tax, compared with a limited company.

Disadvantages of operating as a partnership

- There is unlimited liability and each partner is personally responsible for all the debts of the partnership. As a partner, your personal assets may be seized if the business is unable to pay its debts.
- Problems can occur when there are disagreements between partners.
- All partners can be held responsible for any one partner's negligence. This is important, because each partner can make a binding contract without the authority of the others.
- It is possible for an individual partner to make business decisions without informing the other partners.
- If a partner resigns, dies or goes bankrupt, the partnership must be dissolved. If there is no Deed of Partnership, the partnership is governed by the Partnership Act 1890.

Limited partnerships

A limited partnership has at least one partner who is a general partner - this means they have management rights and are liable for all the partnership's debts - and at least one limited partner. The limited partner, who may be an individual or a business, contributes a fixed amount (as capital or property) to the partnership, but is only liable for partnership debts or liabilities up to the amount they have contributed. The limited partner may not take back any part of their contribution during the partnership's lifetime, and cannot take part in the management of the business.

A limited partnership must register its details with Companies House.

Limited liability partnerships

A limited liability partnership (LLP) has the flexibility and tax status of a partnership, the benefits of limited liability, but also some of the administrative requirements of a limited company. This means:

- The liability of the partners is limited to their capital contribution. Personal assets cannot be seized to settle the LLP's debts.
- LLPs have a separate legal identity so claims are made against the organisation and not the individual partners.

- LLPs are required to register with Companies House and are treated in a similar manner to companies with regard to insolvency procedures.
- Taxation is the same as for an ordinary partnership, so the partners are regarded as self-employed and taxed on their individual share of the profits.
- LLPs must prepare and deliver annual accounts to the Registrar of Companies at Companies House and submit an annual return.

See BIF 365 A Guide to Setting up a Business as a Limited Liability Partnership for a more detailed explanation.

Hints and tips

- If you plan to set up a business as a standard partnership without limited liability, ask your solicitor how you can safeguard your personal assets in the event of your partnership being unable to meet its debts.
- Each partner will be filing self-assessment tax returns, so it is important to keep track of all transactions in clear and up-to-date records.
- Always seek professional advice from a business adviser or solicitor before forming a partnership.

Further information

For practical start up and small business tips, ideas, know-how and news, go to:
Website: www.enterprisequest.com

To access hundreds of practical factsheets, market reports and small business guides, go to:
Website: www.scavenger.net

BIF 6 An Introduction to Insurance Cover for Business
BIF 15 An Introduction to Tax, National Insurance and VAT
BIF 32 Choosing the Right Legal Status for your Business
BIF 66 An Introduction to Setting up a Co-operative Business
BIF 239 A Guide to National Insurance
BIF 264 A Guide to Tax Self-assessment for the Self-employed
BIF 329 A Guide to the Organisations You Must Contact When Starting Up
BIF 341 An Introduction to Business Regulations When Starting Up
BIF 365 A Guide to Setting up a Business as a Limited Liability Partnership

'Partnership Law'
Geoffrey Morse
2006
Oxford University Press

'Are you thinking of working for yourself?'
(SE1)
HM Revenue & Customs
Website: www.hmrc.gov.uk/leaflets/se1.pdf

HM Revenue & Customs
Tel: 0845 915 4655 (Self-employed contact centre)
Tel: 0845 915 4515 (Helpline for the newly self-employed)
Tel: 0845 900 0444 (Self-assessment helpline)
Website: www.hmrc.gov.uk

Companies House
Crown Way
Cardiff
CF14 3UZ
Tel: 030 3123 4500
Website: www.companieshouse.gov.uk

Companies House (Scotland)
4th Floor
Edinburgh Quay 2
139 Fountainbridge
Edinburgh
EH3 9FF
Tel: 030 3123 4500
Website: www.companieshouse.gov.uk

Companies House (Northern Ireland)
Waterfront Plaza
8 Laganbank Road
Belfast
BT1 3BS
Tel: 030 3123 4500
Website: www.companieshouse.gov.uk

CONTACT-

for further information.