CHAPTER 20

PARTNERSHIP ADMISSIONS AND RETIREMENTS

20.1 Introduction

If new partners are being introduced to a partnership or partners are retiring from a partnership, there will inevitably be a change in the profit sharing ratios. We still follow our basic rules – we adjust the profits, allocate them between the partners using the "partnership changes" rules, then treat the partners as individual sole traders (ie, taxing their profits using CYB rules or opening/closing year rules).

20.2 Partner admissions

If a new partner is coming into the practice, we still adjust the accounting profit in the normal way.

We then allocate the profit for the accounting period. A partner being admitted causes a **change in the profit sharing ratio** for allocation purposes. The new partner will be entitled to a share of profits, so PSRs will change. Therefore we **follow the change in profit ratio rules** and split the accounting period around the admission date (ie, the date when the ratios changed).

Once we have allocated the profit, we treat all partners as separate sole traders, and each partner will take the allocated profits to their self assessment returns. Continuing partners will be taxed on their profits using normal CYB rules as we have seen before.

However, the partner who has **joined the partnership** in the year will have his profits taxed using the **commencement rules,** ie, the same opening year rules that sole traders would adopt when starting in business. The new partner is deemed to have commenced trading when he joined the partnership, and to have an accounting date which falls in line with the partnership date.

Illustration 1

Ben and Emily are in partnership sharing profits 60:40. Victoria is admitted into the partnership on 1 February 2010 and the profits are shared equally between the three of them from that date. Adjusted profits for the year to 31 July 2010 are £130,000. Budgeted profits for the year to 31 July 2011 are £150,000. No further change in the profit sharing ratios is expected.

When Victoria comes into the practice on 1 February 2010, the ratios will change. First we deal with the period 1 August 2009 to 31 January 2010, then we deal with the post admission period, 1 February 2010 to 31 July 2010.

	Total	Ben	Emily	Victoria
	£	£	£	£
1.8.09 – 31.1.10 (6m)				
Adjusted profit				
($\frac{6}{12}$ x £130,000)	65,000			
Ratio 60:40	(65,000)	39,000	26,000	
1.2.10 – 31.7.10 (6m)				
Adjusted profit				
($\frac{6}{12}$ x £130,000)	65,000			
Ratio 1:1:1	(65,000)	21,667	21,667	21,666
		60,667	47,667	21,666
		Y/e 31.7.10 ∴ 2010/11 under CYB		1.2.10 – 31.7.10 opening year rules

Ben and Emily were both present for the whole of the year, so they would record their profits on their tax return for 2010/11 under current year basis.

The rules are different for Victoria. She was not present for the whole accounting period, therefore her allocation of £21,666 is for the period 1 February 2010 to 31 July 2010 only. Therefore when computing Victoria's taxable profits, we must use the **commencement rules**.

Victoria joined on 1 February 2010 - that is deemed to be her commencement date. Effectively we treat her as a sole trader commencing on 1 February 2010 with an accounting date of 31 July 2010. Her profits for this 6-month period are £21,666. Her budgeted profit share for the year ended 31 July 2011 is £50,000 (one-third of £150,000).

Summary:

	£
1.2.10 – 31.7.10 (6 month AP)	21,666
1.8.10 – 31.7.11 (12 month AP)	50,000

Victoria's assessments under the normal opening year rules are as follows:

2009/10	
1.2.10 – 5.4.10	
$\frac{2}{6}$ x £21,666	£7,222
2010/11	
First 12 months, i.e. 1.2.10 – 31.1.11	
£21,666 + $\frac{6}{12}$ x £50,000	£46,666
2011/12	
Y/e 31 July 2011	£50,000

As is normal in opening years, Victoria will have overlap profits as follows:

Overlap profits		£
1.2.10 – 5.4.10 (2 months)		7,222
1.8.10 – 31.1.11 (6 months)	= $\frac{6}{12}$ x 50,000	25,000
		£32,222

Victoria has 8 months of overlap, which is what we expect with a 31 July year end (i.e. 8 months away from 5 April). **Note that this overlap belongs to Victoria, not to the partnership**. These overlap profits will be relieved when Victoria ceases trading – ie when she retires from the partnership.

The other partners will have their own overlap profits. These will either be "real" overlap arising on the commencement of trade, or transitional overlap if the business started before April 1994.

20.3 Partners retiring

When partners retire, again there are three basic steps in calculating the partners' taxable profits.

First adjust the accounting profit. Then allocate using the **change in profit ratio** principle, by splitting the accounting period around the retirement date. **When a partner retires the profit ratios must change** - one partner has gone, therefore he will have no profit entitlement from that date.

Once profits have been allocated for the accounting periods concerned, we treat the partners as individual sole traders and tax their profits accordingly. Continuing partners are assessed under CYB. However, **the retiring partner will be assessed using the usual cessation rules.** Overlap profits will reduce the final year assessment for the retiring partner.

Illustration 2

Fred, George & Hannah are in partnership sharing profits 40:30:30. Fred retires from the partnership on 1 September 2010. Profits are then shared equally between George and Hannah. Adjusted profits for the year to 31 December 2010 are £90,000. Fred had overlap profits brought forward of £5,000.

Each of the partners will have their own overlap profits brought forward – we do not need to know what George and Hannah's overlap profits are because they are not retiring. We need Fred's because his profits will be assessed under the cessation rules and his overlap profits will be relieved.

Fred's retirement on 1 September 2010 brings a change in ratios as follows:

	Total	Fred	George	Hannah
	£	£	£	£
1.1.10 – 31.8.10 (8m)				
Adjusted profit				
($\frac{8}{12}$ x £90,000)	60,000			
Ratio 40:30:30	(60,000)	24,000	18,000	18,000
1.9.10 – 31.12.10 (4m)				
Adjusted profit				
($\frac{4}{12}$ x £90,000)	30,000			
Ratio 1:1	(30,000)	_____	15,000	15,000
		24,000	33,000	33,000
		1.1.10-31.8.10 closing year rules	y/e 31.12.10 ∴ 2010/11 under CYB	

George & Hannah's allocated profits for the year ended 31 December 2010 are taxed in 2010/11 under CYB. Fred was not present for the whole year, therefore his £24,000 relates to the period from 1 January 2010 to 31 August 2010. Fred's retirement date is his cessation date for current year basis.

Under the cessation rules, Fred's final tax year is 2010/11. He is simply taxed on profits from the end of the 2009/10 basis period (1.1.10) to the date of cessation (31.8.10). Relief is given for any overlap profits brought forward.

2010/11	£
Final accounting period (1.1.10 – 31.8.10)	24,000
Less: overlap relief (given)	(5,000)
Trading Income assessment	£19,000

20.4 Effect of partnership changes on capital allowances

A change in the composition of a partnership will normally be treated as a "succession" for capital allowances. This means that if a partner joins or leaves, there is **no cessation of trade for the "old" business and no commencement of trade for the "new" business**. Capital allowances are simply given as normal and are deducted from the profits for the accounting period before the profits are allocated between the partners and the opening/closing year rules are applied. CAA 2001, s. 558

If, however, all of the "old" partners leave the business and are succeeded by a full set of new partners (i.e. there is no common partner before or after the change), this will not be a succession. Instead **the "old" partnership is treated as ceasing to trade** and in so doing will sell all plant and machinery to the "new" partnership for its market value. **This will give rise to balancing adjustments** in the respective plant and machinery pools. CAA 2001, s. 559

Example 1

Joy and Roy are in partnership sharing profits 55:45, after charging a salary to Roy of £3,000. Flo is then admitted into the partnership on 1 December 2009. Profits are shared equally from that date after salaries of £2,000 to Joy and £4,000 to Roy.

The adjusted profits for the year to 30 June 2010 are £160,000. The adjusted profits for the year to 30 June 2011 are budgeted to be £170,000.

Calculate Flo's assessable profits for 2009/10, 2010/11 and 2011/12.

Example 2

Ruth, Reg and Roger are in partnership sharing profits 32:38:30, after crediting Roger with a salary of £3,000. Roger retired on 31 December 2010 and profits are shared equally between Ruth and Reg from that date.

The adjusted profits for the year to 31 January 2011 were £174,000. Roger had overlap profits brought forward of £10,000.

Calculate Roger's assessable profits for 2010/11.

Answer 1

	Total	Joy	Roy	Flo
Y/e 30.6.10	£	£	£	£
1.7.09 – 30.11.09 (5m)				
Adjusted profit ($\frac{5}{12}$ x £160,000)	66,667			
Salary ($\frac{5}{12}$ x £3,000)	(1,250)		1,250	
	65,417			
Ratio 55:45	(65,417)	35,979	29,438	
1.12.09 – 30.6.10 (7m)				
Adjusted profit ($\frac{7}{12}$ x £160,000)	93,333			
Salary ($\frac{7}{12}$ x£2,000/ £4,000)	(3,500)	1,167	2,333	
	89,833			
Ratio 1:1:1	(89,833)	29,944	29,944	29,945
		67,090	62,965	29,945
		CYB 2010/11		opening year rules
Y/e 30.6.11				
Adjusted profits	170,000			
Salaries	(6,000)	2,000	4,000	
	164,000			
Ratio 1:1:1	(164,000)	54,667	54,667	54,666
		56,667	58,667	54,666
		CYB 2011/12		opening year rules

CYB opening year rules for Flo:

2009/10	
1.12.09 – 5.4.10	
$\frac{4}{7}$ x £29,945	£17,111
2010/11	
12m to 30.11.10	
(£29,945 + $\frac{5}{12}$ x 54,666)	£52,723
2011/12	
Y/e 30.6.11	£54,666
Overlap profits	
£17,111 + 22,778	£39,889

Answer 2

y/e 31 January 2011	Total	Ruth	Reg	Roger
	£	£	£	£
1.2.10 – 31.12.10 (11m)				
Adjusted profit				
($\frac{11}{12}$ x £174,000)	159,500			
Salary ($\frac{11}{12}$ x £3,000)	(2,750)			2,750
	156,750			
Ratio 32:38:30	(156,750)	50,160	59,565	47,025
1.1.11 – 31.1.11 (1m)				
Adjusted profit				
($\frac{1}{12}$ x £174,000)	14,500			
Ratio 1:1	(14,500)	7,250	7,250	______
		57,410	66,815	49,775
		CYB 2010/11		closing year rules

CYB cessation rules for Roger:

Final AP: 1.2.10 – 31.12.10

	£
2010/11	
Roger's share of profits	49,775
Overlap relief	(10,000)
	£39,775