What is a partnership?

An ordinary partnership is formed when two or more individuals choose to start a business together. A partnership is not a separate legal entity and needs no special paperwork to form, although a partnership agreement is recommended.

Partnerships require very little administration except for registration with HMRC. The partners typically pay tax as if they are self-employed, although it is possible to have salaried and corporate partners.

The disadvantages are that the partners are jointly liable for any business and financial risk that the partnership faces. This means that all the partners are liable for any debts, even if those debts were created as a result of only one partner's actions.

An ordinary or general partnership is distinct from a legal limited liability partnership, and different rules apply.

How to start a partnership business

According to HMRC, the definition of a partnership is: "The relation which subsists between partners carrying on a business in common with a view to profit."

Starting a partnership simply requires two or more people to agree to go into business together. Partnerships are not separate legal entities, like limited companies, and do not legally require any paperwork or formal creation process, except registration with HMRC.

However, it is advisable to create a partnership agreement when the partnership is formed. A partnership agreement, which is also known as a deed of partnership or articles of partnership, will typically describe how the partnership should be run and, crucially, how business profits will be shared. It may also nominate a partner who is responsible for managing any statutory requirements, such as the tax affairs of the partnership.

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It will also include details of how much each partner has invested, what their roles in the business are, who can agree contracts and how, the leaving procedure for partners who want to quit or if a partner dies and what happens if there is a dispute or if something goes wrong.

The Partnership Act 1890 applied if there is no partnership agreement

If there is a dispute between the partners or something goes wrong and there is no partnership agreement, then the provisions of the Partnership Act 1890 will apply to settle the dispute.

Where there are only two partners in a partnership, and one of the partners resigns, is made bankrupt or dies, then because it has no legal status the partnership is dissolved.

Once the partnership has been created the name of the business and all of the partners' names must be displayed on all of the partnership's official paperwork, such as its letterhead and invoices.

What kinds of partners can start a partnership?

There are four types of partner that can be part of a partnership business:

A general partner

Silent or sleeping partners

Salaried partners

Corporate/limited company partners.

Silent or sleeping partners do not usually become involved in the day-to-day administration of the business but they have become a partner because they have invested in the business. Even though they choose not to involve themselves in the decision making, are still liable for the partnership's debt.

A salaried partner can be an employee who is not in fact a partner but is given the title of partner and receives a salary. The salary may in part be based on the partnership's profits, and the salaried partner may appear on the partnership's letterhead, but they won't be liable for any debts of losses, as a general partner would. A salaried partner could also be a general partner but who has a preferential claim on any profits.

As separate legal entities in their own right, limited companies can also be partners.

What tax do partnerships and their partners pay?

Partnerships must file a partnership tax return with HMRC that details the business's income and expenditure and resulting profit. However, the partnership itself does not pay tax – it passes the profits in the business through to the partners.

The exact profit that comes to each partner is determined by the partnership agreement, or they receive equal shares if there is no agreement. Each of the partners must then complete a self-assessment tax return that details all of their income, including partnership profits, on which they pay income tax and National Insurance Contributions (NICs) as self-employed individuals.

Partners are subject to the same income tax bands as sole traders and employees, although limited company partners are subject to different rules. Partners have a personal allowance of £10,000 on which they pay no income tax. Then they pay the 20% basic rate of income tax on the next £31,865 of profits, the higher rate of 40% on profits of between £31,865 and £150,000, and the additional rate of 45% on any profits over £150,000.

Partners also pay two types of National Insurance Contributions (NICs). Class 2 NICs are paid at a rate of £2.75 per week and Class 4 NICs are calculated as part of the self-assessment process, and are based on the partner's earnings.

A partner must submit their self-assessment tax return online by 31 January following the end of the tax year, which is 5 April (paper tax returns must be submitted three months earlier, by 31 October). Any tax owed must be paid in full by the 31 January deadline.

Like self-employed sole traders, partners are also required to make income tax payments on account. The payment on account is calculated based on the previous year's earnings. If a partner's income looks like it will be considerably less in a subsequent year, it is possible to negotiate a reduction with HMRC.

The benefits and risks of trading via a partnership

Partnerships offer simplicity, reduced administration and, up to a certain level of income, tax efficiency. If the business needs funds to grow, it is also possible to raise finance by introducing a new partner. There are no accounts to file, although business records must still be maintained and tax returns for the partnership and the partners must be filed.

A partnership is not a separate legal entity, so the partners bear all the risks of the partnership business, including any debts and liabilities. What is crucial is that the partners are jointly and severally liable for business debts. That means that if the business can't pay a supplier, or has to make a payout after being sued, then the partners are personally liable for that debt. All of the partners are responsible for the debts that any one of them incurs.

That liability will remain, even after the partnership has been dissolved, or if a partner has left the business, unless they come to an arrangement with the surviving partners. However, new partners will not be liable for debts incurred before they joined the partnership.

Securing work directly from clients/agencies

Many partnerships find it difficult to secure work from clients or requirement agencies. That is because if the client/agency engages the partnership, they are hiring the individual partners directly. The partnership is not a separate legal entity – there is no intermediary between the engager and the workers.

This situation is risky for the client/agency for two reasons. Firstly, in some circumstances because of the nature of the role and relationship, the individual partner or partners supplying the services may decide they qualify for employment rights. Without an intermediary, these workers may have a case. That's why contractor clients and agencies insist on having a limited company or **umbrella company** as an intermediary.

It is also possible that, if the partners who pay tax as if they are self-employed do not pay the income tax and NICs that they should, under some circumstances HMRC may come after the agency or the client for the unpaid tax.

Partnerships can be an ideal solution for some types of business, as this structure offers simplicity and flexibility for several individuals to work together without the administrative burden of incorporating and running a company. It can also be tax efficient, up to a certain level of income. A partnership can also raise money for growth by introducing new partners.

However, for businesses with higher fee potential, a partnership does not provide the tax efficiency or protection from financial risk that an alternative, such as a limited liability partnership or limited company, will deliver.

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