

PARTNERSHIPS AND CAPITAL GAINS TAX

This Help Sheet gives you information to help you complete the Capital Gains Pages of your Tax Return. It explains how partners are treated for Capital Gains Tax. But it is only an introduction. If you are in any doubt about whether you have made a chargeable gain, or allowable loss, as a partner, ask your tax adviser.

Your Inland Revenue office will also be pleased to help. You can ask to see the Inland Revenue Capital Gains Manual; this explains the rules in detail.

HOW ARE PARTNERSHIPS TREATED FOR CAPITAL GAINS TAX?

Partnerships are treated as transparent for Capital Gains Tax. Each partner is responsible for returning any capital gains arising on the disposal of their interests in the assets of the partnership.

This applies to Scottish partnerships as well as those in England, Wales and Northern Ireland.

While this also applies to partnerships which include companies as members, the rules for computing gains of companies, which are chargeable to Corporation Tax, are different from those for individuals. The contents of this Help Sheet do not therefore apply to companies who are members of partnerships.

WHEN YOUR TAX OFFICE SHOULD BE GIVEN DETAILS OF ANY CAPITAL GAINS

You should fill in the Capital Gains Pages if you were a member of a partnership during the year and any of the following happened:

- the partnership disposed of an asset during the year (for example, it sold part of its business premises), **or**
- you left the partnership during the year, **or**
- there was a change in the partnership during the year and you now have a reduced share in the partnership assets (for example, a new partner joined).

HOW DO YOU KNOW WHAT YOUR SHARE IN THE ASSETS IS?

Partners are treated as each owning a fractional share in all the assets of the partnership. The amount of your share will be decided by:

- any written agreement showing how you and your partners will share the assets
- any written agreement showing how you and your partners will share the profits
- the rules in the 1890 Partnership Act which treats you all as having equal shares.

Example 1

Bill and Ted are in partnership and agree to share profits equally. This means that they are each treated as having a 50% interest in the assets of the partnership.

WHEN YOU DISPOSE OF ALL OF YOUR SHARE

You dispose of all of your share in an asset if this is disposed of to someone outside the partnership.

Example 2

Jack and Jill are equal partners in a farm. They sell part of the farm land to their neighbour in May 1999. Each has disposed of all of their 50% interest in that part.

You also dispose of all your share if you leave the partnership completely, for example, when you retire.

Example 3

Jack reaches retiring age and leaves the partnership in December 1999. He disposes of all of his 50% share in the remaining assets to Jill.

WHEN YOU DISPOSE OF PART OF YOUR SHARE

You may dispose of part of your share in an asset if the original agreement is altered. This most commonly happens when a new partner joins.

Example 4

Bill and Ted are joined by a new partner Alice in July 1999. They now agree to share profits on a 40/40/20 basis. This means that Bill and Ted have each disposed of 10/50 of their original shares.

It may also happen when the partners rearrange matters between themselves.

Example 5

After six months, Bill, Ted and Alice become equal partners. They now share profits on $33\frac{1}{3}$ basis. Bill and Ted have now made a further disposal of $\frac{6\frac{2}{3}}{40}$ of their revised shares.

WHEN YOU ACQUIRE YOUR SHARE

If the asset is acquired from someone outside the partnership, you acquire your original share in it then.

Example 6

The partnership of Bill, Ted and Alice buys a new piece of machinery in March 2000. Each now has a $33\frac{1}{3}$ share in that asset.

WHEN YOU ACQUIRE A FURTHER SHARE

You may acquire a share or a further share in the asset if the original agreement is altered. This most commonly happens when a partner leaves.

It may also happen when the partners rearrange matters between themselves.

Example 7

Bill resigns from the partnership on 5 April 2000 and disposes of his share in the assets to Ted and Alice. At the same time, they agree to revise their shares to 40/60. As a result, Ted acquires a further $\frac{6}{3}$ share from Bill, Alice acquires a further $\frac{26}{3}$.

WHAT DO YOU NEED TO DO IF YOU HAVE DISPOSED OF PART OF YOUR SHARE?

If you have disposed of any part, or all, of your share in a partnership asset, then you need to calculate any chargeable gain and enter it in your Capital Gains Pages.

Points to remember:

- **you are treated as having a fractional share in the partnership assets**
- **you can acquire that share**
 - **when an asset is acquired from someone outside the partnership**
 - **when there is a reorganisation within the partnership**
- **you can dispose of that share**
 - **when an asset is disposed of to someone outside the partnership**
 - **when there is a reorganisation within the partnership.**

HOW YOU CALCULATE ANY CHARGEABLE GAINS

Most of the normal rules for calculating chargeable gains still apply to disposals of shares in partnership assets. This Help Sheet explains these briefly. If you need help with these, you should ask your Inland Revenue office or your tax adviser.

The normal rules do not apply if you acquired your share in the asset from, or disposed of it to, another partner. See 'The Special Rules' section on page 3.

THE NORMAL RULES

There are rules which you have to use if you are calculating a chargeable gain on the disposal of a share in a partnership asset. These affect:

- the amount you should include for the disposal proceeds of your share in the asset
- the amount you can deduct for the allowable cost of your share in the asset
- whether you should use your share of the 31 March 1982 value of the asset
- the amount of indexation allowance you can claim.

The amount to be included for the proceeds of disposal

In calculating your chargeable gain on the disposal of your share in the asset to someone outside the partnership, you normally include your share of the actual disposal proceeds, minus any incidental expenses.

Example 8

When Jack and Jill sold the part of the farm land to their neighbour in May 1999, they received £25,000 for it and incurred legal fees of £5,000. In calculating their chargeable gains, each should include disposal proceeds of £12,500 *minus* expenses of £2,500.

In certain circumstances, you may have to include your share of the market value of the asset at the date of disposal, rather than the actual disposal proceeds. If you think this might apply, you should consult your Inland Revenue office or your tax adviser.

The normal rules do not apply if you have disposed of your share in the asset to another partner. See 'The Special Rules' section on page 3.

How much should you deduct for the cost of the asset?

— Assets acquired after 31 March 1982

If the asset was acquired from someone outside the partnership after 31 March 1982 and you acquired your share when it was acquired, then you deduct your share of the original acquisition cost, plus any incidental expenses.

Example 9

When Bill, Ted and Alice bought their new machinery in 2000, they paid £30,000 for it with incidental expenses of £750. If they sell it, each will be able to deduct acquisition costs of £10,000 and expenses of £250.

In certain circumstances, you may have to deduct your share of the market value of the asset at the date of acquisition, rather than the actual cost. If you think this might apply, you should consult your Inland Revenue office or your tax adviser.

— **Assets acquired before 31 March 1982**

If the asset was acquired from someone outside the partnership on or before 31 March 1982 and you acquired your share when it was acquired, then you may be able to deduct your share of the market value of the asset at 31 March 1982, rather than the actual cost.

You should ask the Orderline for *Help Sheet IR280 Rebasing - assets held at 31 March 1982*.

The normal rules do not apply if you acquired your share in the asset from another partner. See 'The Special Rules' section in the next column.

How much indexation allowance can you claim?

In calculating your chargeable gain on the disposal of your share in the asset to someone outside the partnership, you may be able to deduct an additional allowance, called the indexation allowance.

This applies if you acquired your share in the asset before 6 April 1998 and is based on your share of the cost of the asset, or the 31 March 1982 market value, multiplied by the difference in the retail prices index between the months you acquired it and April 1998.

Example 10

If the partnership of John and Paul bought machinery in February 1989 for £20,000 and sell it in May 2000, they are each able to deduct an indexation allowance of:

$$\frac{(\pounds 20,000 \times 0.454)}{2} = \pounds 4,540$$

Details of the indexation allowance for each month are given on page CGN16 of the Notes on Capital Gains. The normal rules do not apply if you acquired your share in the asset from, or disposed of it to, another partner. Read 'The Special Rules' section in the next column.

How much taper relief can you claim?

You may also be able to reduce the amount of any chargeable gain on the disposal of your share in a partnership asset by taper relief. Details of this relief, which is based on the length of time you have owned your share in the asset after 6 April 1998, are given in the Notes to the Capital Gains Pages.

Points to remember:

- **you should include your share of the disposal proceeds, less any incidental expenses**
- **if you acquired your share in the asset**
 - **after 31 March 1982, you should deduct your share of the original acquisition cost, plus any incidental expenses**
 - **on or before 31 March 1982, you may have to use your share of the market value at that date.**

THE SPECIAL RULES

There are special rules that apply if you acquired your share in the asset from another partner or have disposed of it to another partner. These affect:

- the amount you should include for the disposal proceeds
- the amount you can deduct for the allowable cost
- whether you should use your share of the 31 March 1982 value of the asset
- the amount of indexation allowance you can claim.

This Help Sheet summarises the way the special rules work.

If you need further assistance, ask your Inland Revenue office or tax adviser.

Disposal proceeds

If you dispose of your share in the asset to another partner, then the special rules treat the disposal proceeds as your share of the balance sheet value of the asset.

Example 11

When Bill resigns from the partnership, the chargeable assets in the balance sheet are:

Property	£240,000
Machinery	£180,000
Goodwill	£60,000

Bill had a 33¹/₃ share in the assets, so his disposal proceeds are:

Property	£80,000
Machinery	£60,000
Goodwill	£20,000

This rule **does not** apply if you have received actual consideration from the other partner over and above the balance sheet value.

In that case, ask your Inland Revenue office or tax adviser.

This rule **may not** apply if you and the other partner are connected persons for example, father and son. In that case, you should ask your Inland Revenue office or your tax adviser.

Acquisition cost

If you acquire your share in the asset from another partner, then the special rules treat the acquisition cost as your share of the balance sheet value of the asset.

Example 12

When Bill resigned, Ted acquired 6²/₃ of his share in the assets. His acquisition cost of that share will be:

Property	£16,024
Machinery	£12,007
Goodwill	£4,002

This rule does not apply if you have given actual consideration to the other partner over and above the balance sheet value. In that case, ask your Inland Revenue office or tax adviser.

This rule may not apply if you and the other partner are connected persons, for example, father and son. In that case, ask your Inland Revenue office or tax adviser.

Transfers at balance sheet value

Because the special rules treat acquisitions and disposals as taking place at balance sheet value, then you may have to use the same figure for both disposal consideration and acquisition cost.

This will depend on whether the assets have been revalued since you acquired your share in them.

— **Assets not revalued**

Example 13

Charles became a member of a partnership in 1990. He was entitled to a 25% share in the assets. In the balance sheet, these were shown as:

Property	£400,000
Goodwill	£80,000

Charles made no payment for his share, so his acquisition costs are:

Property	£100,000
Goodwill	£20,000

In 1999, Andrew joins as a partner, and Charles reduces his share to 20%.

The assets are still in the balance sheet at £100,000 and £20,000, so Charles will use $\frac{5}{100}$ of those values as both his acquisition costs and disposal proceeds for the 5% he transfers to Andrew. He therefore makes neither a gain nor a loss.

A situation such as this is referred to as a no gain/no loss disposal.

If, however, the assets in the balance sheet have been revalued, then gains or losses may arise.

— **Assets revalued**

Example 14

In 2000, Edward joins the partnership and Charles makes a further 5% reduction in his share. By now, the assets have been revalued to:

Property	£1,000,000
Goodwill	£10,000

As the assets have been revalued, Charles' acquisition costs and disposal proceeds are now different:

Property acquisition	5% x £400,000	£20,000
disposal	5% x £1,000,000	<u>£50,000</u>
gain before indexation and taper relief		£30,000
Goodwill acquisition	5% x £80,000	£4,000
disposal	5% x £10,000	<u>£500</u>
loss		£3,500

Rebasing; indexation and taper relief

The special rules modify the way in which the normal rules for assets held at 31 March 1982 and for calculating the indexation allowance work. They do not modify the way in which taper relief works.

The effect of the special rules depends on when the various disposals or acquisitions take place. If you acquired a share in a partnership asset before 6 April 1988 and have now disposed of that share, ask your Inland Revenue office or tax adviser for help.

There are detailed flow charts in Volume 2 (Partnerships) of the Capital Gains Manual which take you through the various stages. You can ask to see these.

Points to remember:

- **transfers of shares between partners take place at balance sheet value unless actual consideration is paid**
- **where no consideration is paid, gains or losses will only arise where the balance sheet has been revalued**
- **the rules for rebasing and indexation may be different.**

These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.