PARTNERSHIP

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Partnership is an exam area where most students fail to achieve good marks. It is however a straightforward arithmetical area, always encompassing the rules on commencement and cessation.

The main reasons that students fail in partnership questions are:

1. Calculating tax assessments worked on the partnership profits rather than **each individual's share** of the partnership profits. The partnership is NOT assessable to tax – each **individual** in the partnership is assessed.

2. Failing to divide the accounting profit and capital allowances correctly between each partner.

3. Lack of knowledge of the rules applicable in commencement and cessation including the taxpayer's year 3 option for the partner in commencement and the penultimate year review on the partner in cessation.

The procedure for all partnership questions is the same. There are three steps. Students should be able to achieve quite high marks on a partnership question once it is approached in the methodical 3 step fashion as outlined in the following example. (Note in the following example that the tax year 2000 is taken on the basis of the 1st January to the 31st December):

A, B and C were in partnership for many years. C retired on the 30th September 2001. D joined the partnership on the 1st July 2002. Profits were shared equally at all times.

The recent profits of the partnership were as follows:

	€
Year ended 31st March 2000	*27,000*
Year ended 31st March 2001	*33,750*
Year ended 31st March 2002	*36,000*
Year ended 31st March 2003	*45,000*
Year ended 31st March 2004	*48,000*

Capital allowances have been agreed as follows:

	€
Year ended 31st December 2000	*6,000*
Year ended 31st December 2001	*10,000*
Year ended 31st December 2002	*12,000*
Year ended 31st December 2003	*15,000*

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Show the tax assessments for each partner for the tax years 2000 to 2003

<u>STEP 1 – Divide profits in accordance with the profit sharing ratio given:</u>

- IGNORE TAX YEARS and only focus on the accounting year end.
- Prepare a schedule that shows the division of the partnership profits between the partners PHYSICALLY PRESENT during the ACCOUNTING YEAR.
- It is very important to note that C retired ½ way through the accounts year ending on 31st March 2002 and D joined 3 months after the commencement of the accounts year ending on 1st March 2003:

Accounts year end	**Total €**		**A €**	**B €**	**C €**	**D €**
31st March 2000	27,000		9,000	9,000	9,000	-
31st March 2001	33,750		11,250	11,250	11,250	-
31st March 2002	36,000	x 6/12 = €18,000	6,000	6,000	6,000	-
		x 6/12 = €18,000	9,000	9,000	retired	-
31st March 2003	45,000	x 3/12 = €11,250	5,625	5,625	-	-
		x 9/12 = €33,750	11,250	11,250	-	11,250
31st March 2004	48,000		16,000	16,000	-	16,000

<u>STEP 2 – Divide capital allowances in accordance with the profit sharing ratio given:</u>

- Prepare a similar schedule for capital allowances dividing the allowances between the partners PHYSICALLY PRESENT during the TAX YEAR.
- You must now note that C was present for 9 months of the tax year 2001 and D was present for the second 6 months of the tax year 2002:

Tax year end	**Total €**		**A €**	**B €**	**C €**	**D €**
31st December 2000	6,000		2,000	2,000	2,000	-
31st December 2001	10,000	x 9/12 = €7,500	2,500	2,500	2,500	-
		x 3/12 = €2,500	1,250	1,250	-	-
31st December 2002	12,000	x 6/12 = €6,000	3,000	3,000	-	-
		x 6/12 = €6,000	2,000	2,000	-	2,000
31st December 2003	15,000		5,000	5,000	-	5,000

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There is no quick way around steps 1 and 2 but without the individual data highlighted by these schedules it is impossible to work out the correct assessments that follow:

STEP 3 – Do individual assessments:

It is only NOW that we look at income tax assessments for the first time! The partnership is not taxed only the individuals in it. By looking in a columnar fashion at the schedules prepared at steps 1 & 2, we can prepare assessments for each individual ONE AT A TIME.

Do not try to prepare assessments for 2 or 3 people at the same time. For A and B the work has been done at this stage and it is just a matter of reading the figures worked out at steps 1 & 2.

ASSESSMENTS FOR A:

Tax year	Basis of assessment	Amount	Capital allowances	Taxable
		€	€	€
2000	Account y/end 31st March 2000	9,000	(2,000)	7,000
2001	Account y/end 31st March 2001	11,250	(3,750)	7,500
2002	Account y/end 31st March 2002	15,000	(5,000)	10,000
2003	Account y/end 31st March 2003	16,875	(5,000)	11,875

ASSESSMENTS FOR B:

Tax year	Basis of assessment	Amount	Capital allowances	Assessed
		€	€	€
2000	Account y/end 31st March 2000	9,000	(2,000)	7,000
2001	Account y/end 31st March 2001	11,250	(3,750)	7,500
2002	Account y/end 31st March 2002	15,000	(5,000)	10,000
2003	Account y/end 31st March 2003	16,875	(5,000)	11,875

ASSESSMENTS FOR C: **C ceased in 2001 so it is necessary to employ the <u>rules on cessation</u> to work out his assessments.**

Tax year	Basis of assessment	Amount	Capital allowances	Assessed
		€	€	€
2000	Account y/end 31st March 2000	9,000	(2,000)	7,000
2001	1st January to 30th September 2001			
	€11,250 x 3/12 plus €6,000	8,812	(2,500)	6,312

Revenue review of penultimate year 2000 profits to actual: €

Original assessment 9,000

Actual: 1st January to 31st December 2000

3/12 x € 9,000 = €2,250

plus	9/12 x €11,250 = €8,437	10,687

As actual gives a higher profit figure, Revenue will revise the 2000 profits assessed upwards.

ASSESSMENTS FOR D: D commenced in 2002 so it is necessary to employ the rules on commencement to work out his assessments:

Tax year	**Basis of assessment**	**Amount**	**Capital allowances**	**Assessed**
		€	**€**	**€**
2002	1st July – 31st December 2002			
	€11,250 x 6/9	7,500	(2,000)	5,500
2003	Actual: 1st January to 31st December 2003			
	3/9 x €11,250 = € 3,750			
	plus 9/12 x €16,000 = €12,000	15,750	(5,000)	10,750

The actual basis was used in 2003 as it was impossible to assess D on the basis of "12 months accounts ending in the tax year." This is due to the fact that D did not share for the whole of the 12 months ending 31st March 2003. As a result, in 2004 there will be no review of Year 2 to actual as 2003 is already on an actual basis.

FINAL ASSESSMENTS SUMMARY:

	A	**B**	**C**	**D**
	€	**€**	**€**	**€**
2000	7,000	7,000	8,687 revised	-
2001	7,500	7,500	6,312	-
2002	10,000	10,000	-	5,500
2003	11,875	11,875	-	10,750

Sometimes, following the retirement or admission of a partner, the profit sharing ratio can change. This does not affect the **steps** outlined above, merely the allocation of the split i.e. 1/3rd each could change to ½ , ¼ and ¼ etc.

Partnership is a very important area for all students preparing for the Formation 2 tax paper. Students should ensure that they can apportion profits and capital allowances correctly as outlined above and then apply the rules on commencement and cessation as appropriate.