THE CURRENT TAX ADVANTAGE OF THE CORPORATE PARTNER

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When there is high profitability in trading partnerships there are concerns regarding the "double blow" of Class 4 National Insurance Contributions (NIC) and the 50% (reducing to 45% from 6 April 2013) rate of income tax. The current "fashion" is to use a limited company ("NewCo") as an integrated part of the commercial enterprise.

Advantage of using a Limited Company

One distinct advantage of the limited company is that the higher rate of income tax is only paid as and when dividends are withdrawn and there is no NIC associated therewith. This has the advantage that where a trading partnership is profitable but has retained this profit in business assets (or reinvested in valuable stock), the introduction of the corporate partner can be a very tax and NIC efficient way of trading.

The rationale behind the use of the limited company is the lower rate of corporation tax on any profits which can result and, if dividends are planned correctly, in total profits being extracted from the business at a lower marginal rate of taxation than if the limited company was not used.

How to proceed

Tax planning revolves around introducing a new limited company (NewCo) into the business as a partner directly. A new partnership agreement can be drafted allocating the majority of the profits generated to NewCo, with only a residual £8,000 'salary' (profit share) paid to the remaining partners directly. This will ensure the partners profit share exceeds the 'lower profits limit' of £7,605 for 2012/2013, efficiently utilising the partners personal income tax allowance, negating the need to operate a PAYE scheme in the Limited company, with only very minimal exposure to 9% Class 4 NIC. This results in the bulk of the profits being assessable on NewCo.

The company would be liable to corporation tax on its share of the profits from the partnership, and these are taxed in exactly the same way as if NewCo had generated these from its own trading activities. Where the Limited company makes profits in excess of £300,000 (apportioned as appropriate for a period of less than 12 months or where there are associated companies) the tax benefit is diluted as the company starts to suffer corporation tax at the higher marginal rate so a careful review of the anticipated profit levels must be undertaken beforehand.

What about Goodwill?

Usually, a profitable business will have some inherent goodwill that makes the business worth more to a third party purchaser than the sum of the net assets on the balance sheet. Any disposal of goodwill to a newly formed NewCo would be a chargeable event for CGT purposes. As NewCo would owe the existing partners for the agreed market valuation of goodwill, the partners can draw down on this debt owed by the NewCo with no further tax effect.

Action Points

For any partnership, the potential tax efficiency of introducing a corporate partner should be thoroughly reviewed with professional advice

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