This fact sheet tells you about how to deal with debts when you run a partnership. A partnership is a business where two or more people carry on business to try and make a profit.

Use this fact sheet to:

- find out whether a partnership exists;
- understand who is liable for a partnership’s debts;
- learn how to deal with partnership debts if there is no spare money available; and
- learn how to deal with partnership debts if there is some spare money available.

What is a partnership?

When two or more people carry on a business to try and make a profit, it is known as a partnership. The word ‘firm’ is also used when referring to a partnership. We use both words in this fact sheet.

A partnership must have at least two partners. The partnership is known as the ‘principle’ and the partners as its ‘agents’.

How do I know if a partnership exists?

When deciding whether a partnership exists, the Partnership Act 1890 applies.

Some partnerships are set up on the basis of a partnership agreement signed by all of the partners. A partnership agreement is normally prepared by a solicitor and usually includes information about:

- how the profits and losses should be shared;
- who has the authority to enter into contracts on behalf of the firm;
- whether salaries will be paid;
- how much of the firm’s debts each partner agrees to pay; and
- the circumstances in which the partnership will be dissolved (closed).

What if there is no written partnership agreement?

If there is no written agreement, it can be difficult to know whether a partnership exists. The Partnership Act 1890 states that if more than one person receives a share of the business profits, this is good evidence that the business is a partnership. The way that the business completes its income tax returns is also important. If you are unsure whether your business is a partnership, contact us for advice.


## Liability for partnership debts

Creditors will initially ask the firm to pay its own debts. If the firm cannot pay, the creditors are likely to ask the individual partners to pay. Partners are ‘jointly and severally liable’ for the firm’s debts. This means that the firm’s creditors can take action against any partner. Also, they can take action against more than one partner at the same time. This applies even if there is a partnership agreement that says otherwise. If one partner pays more than their agreed share of the firm’s debts, they can recover the money that another partner should have paid by taking court action against them, if necessary.

A person who joins a partnership will not be liable for the debts it built up before they joined, unless an agreement is made that says something different.

A person who leaves a partnership will still be liable for the firm’s debts that were built up before they left.

A person who leaves a partnership may still be liable for any debts the firm builds up after they leave. However, they will not be liable if:

- they have agreement to this from the creditors and other partners; and
- their name is removed from the firm’s stationery.

If a partner dies, or is made bankrupt, the partnership and creditors can claim the deceased partner’s share of the debt from their estate.

All partners have a ‘fiduciary relationship’ with the firm. This means that all their actions must be in the best interests of the firm and the other partners. All partners are liable for the actions individual partners take on behalf of the firm.

## Information:

### income tax liability

Partners are not jointly and severally liable for income tax. Each partner must pay income tax on their own share of the firm’s profits.

## Partnership debt options

If your firm is struggling to pay its debts, consider whether it can negotiate with its creditors and trade through its financial difficulties. To do this, you will need to complete a business budget sheet showing the firm’s income and outgoings. You may need help from your accountant as you will need to look at the average income for the firm (normally over a period of between the last 3 and 12 months) as well as its outgoings. The firm may also need to budget for income tax on its profits and value added tax (VAT).

If the firm is making a profit after all its outgoings have been taken into account (a ‘net’ profit), consider whether offers can be made to its creditors.
Net monthly profit available

Informal negotiation

Use your business budget to show how much money is available and how much the firm can offer to its creditors. Business Debtline can help you to complete a partnership budget sheet. Contact us for advice.

Consider which debts are priority and which are non-priority. Priority creditors have stronger powers to get their money back. Our self-help pack gives information about this. Contact us for a copy. If you are unsure of the type of debt your firm has, contact us for advice.

Individual voluntary arrangements

An individual voluntary arrangement (IVA) is a formal agreement with creditors to repay them part of what is owed. It is set up and managed by an insolvency practitioner (IP). A firm can enter into an IVA (called a partnership IVA, or PVA). It is common for the individual partners to enter into an IVA themselves alongside the firm. This is because a PVA would normally only pay back some of the debt. Once a PVA has finished, the individual partners would be liable for the remainder of the debt and would be expected to pay it back. If the individual partners also entered into an IVA, this debt is dealt with.

Entering into a PVA can make it very difficult to continue trading because the PVA is marked on your credit reference file for six years.

No net monthly profit available

Ceasing to trade

If a firm is insolvent, it means that:

- it cannot pay its debts as they fall due; or
- the value of its assets is less than the total debt that it owes.

Ask your accountant for help with drawing up a balance sheet of the firm's assets and debts.

A firm will also be considered as insolvent if it has received a 'statutory demand' and the time limit stated has run out. A statutory demand is a formal demand for money that may be sent by creditors when collecting a debt.

If you are unsure whether your firm is insolvent, contact us for advice.

If you think that your firm is insolvent, you may need to consider ceasing to trade. If you do decide to cease trading, take the following actions.
Inform HM Revenue and Customs (HMRC) for income tax purposes. You will need to complete a final tax return. This cannot normally be done until the 5 April after the date the firm ceases trading. If you have an arrangement in place to pay your income tax, tell HMRC about this when you inform them that you have ceased trading. This is because you may not be able to continue making the agreed payments. If necessary, renegotiate your payments based on your new circumstances. It is usually easier to negotiate an arrangement to repay income tax after you have ceased trading. Contact us for advice.

If you are registered for VAT, you also need to inform the VAT department at HMRC that you have ceased trading. You will need to ‘de-register’ for VAT and complete a final return. It is usually easier to negotiate an arrangement to repay VAT after you have ceased trading. Contact us for advice.

Extra advice:

**further help**

If you are on a low income and you need further help with personal tax issues, contact TaxAid. TaxAid is an independent charity. See Useful contacts at the end of this fact sheet.

**accountants**

If you cannot pay your accountant to complete your final accounts, contact us for advice.

See our fact sheet:

Income tax debt

Useful contacts

TaxAid
Phone: 0345 120 3779 Mon – Fri 10am – 12 midday
www.taxaid.org.uk