

A Guide to Dissolving a Partnership

Business Information Factsheet

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Introduction

Business partnerships may be dissolved by an agreement between partners or by a notice of dissolution given by one partner to the other(s). However, it is important for anyone taking this course of action to seek advice regarding certain legal, taxation and financial matters.

This factsheet explains how to go about dissolving a partnership, and covers the implications of partnership agreements and the Partnership Act 1890.

The factsheet is not intended to be a comprehensive guide to this specific area of the law and does not apply to individual situations. Business partners should consult a lawyer if specialist information and advice on this topic is required.

What is a partnership?

A partnership can be either an ordinary partnership or a limited liability partnership (LLP).

Ordinary partnerships

An ordinary partnership, usually simply known as 'a partnership', is legally defined by the Partnership Act 1890 and is the format commonly chosen to set up a business that will be owned by two or more sole traders. This kind of partnership does not have to be registered with Companies House.

In a partnership, two or more people set up in business together. They share all the risks, costs and responsibilities, as well as the profits. One consequence of this is that partners are liable for the debts and obligations of the partnership without limit. Liability is joint in the case of contractual obligations, and joint and several (meaning a claimant can sue either one or all the partners for the full amount of their claim) in the case of tortious obligations (obligations owed not by contractual agreement between the parties, but by law) as a partnership has no separate legal identity.

A partnership relationship can exist as the result of a contract with no formal requirements: that is, it can be oral or written. To determine if a partnership exists, the courts look at:

- The intention of the parties.
- Sharing of profits and losses.
- Joint administration and control of the business operation.
- Capital investment by each partner.
- Common ownership of property.

Partnerships may begin easily and informally, but often don't end that way. Some experts have compared them to marriage - simpler to start than to finish.

Limited Liability Partnerships

A Limited Liability Partnership (LLP) is a form of partnership that is legally defined under the Limited Liability Partnerships Act 2000 and requires at least two partners (known as 'members'). This type of partnership must be registered or incorporated with Companies House when it is set up.

LLPs have similar flexibility and tax status to ordinary partnerships, but with the benefits of limited liability. They can be advantageous in certain circumstances because the withdrawal of capital is easier than through a limited company.

Under an LLP, members are liable only for the amount of capital they invest and therefore they benefit from the same protection as a limited liability company. Despite its title, an LLP is not a partnership in the ordinary sense. It is a 'body corporate' with a separate legal identity so it can be more closely compared to a limited company than a partnership.

Unlike ordinary partnerships, LLPs do not have to be dissolved on the resignation, death or bankruptcy of a member. Instead, the Limited Liability Partnerships Act 2000 applies a modified form of the law relating to the insolvency and winding up of companies to the dissolution of LLPs. The courts have largely applied corporate insolvency law to LLPs, so that they are on a similar footing to companies when the LLP ends.

How to dissolve an ordinary partnership

Most ordinary partnerships are 'at will'. This means that there is no formal limit on the amount of time the partnership is intended to last.

The Partnership Act 1890 governs the creation, organisation and dissolution of partnerships if they are not dealt with specifically by a partnership agreement.

Partnerships can be dissolved in five key ways:

1. Automatic dissolution

- **Death or bankruptcy.** Sometimes a partnership will be dissolved automatically - even if some of the partners don't appreciate what is happening. Under the Partnership Act 1890, partnerships will be dissolved from the date of death or bankruptcy of any partner, unless there is something in the partnership agreement that states otherwise. In practice, most partnerships will avoid unwanted termination by drafting their partnership agreement so that the death of a partner will lead to the same outcome as retirement, while the bankruptcy of a partner will be treated as if they had been expelled, and the partnership can continue without them.
- **Technical dissolution.** A technical dissolution may occur if any members of the partnership change. In such cases, the business may continue largely as before, although with a difference in the membership of the partnership.
- **Illegality.** Under the Partnership Act 1890, partnerships are dissolved when an event occurs that makes it unlawful for the business to continue or for partners to carry on as

a partnership. For example, if a solicitor's practising certificate lapses, partnerships with that solicitor will automatically be dissolved. However, if other solicitors in the partnership continue in business, a new partnership will automatically be formed.

- **Expiration.** The aim of the Partnership Act 1890 is to dissolve partnerships formed for a fixed term or for a single undertaking once the term or task has been completed - unless otherwise agreed. However, if the partners continue in business, they will be presumed to be partners on the same terms as before, except that their new partnership is a partnership at will, ie it can be dissolved at any time providing the right conditions are fulfilled.

2. By notice

Partnerships can be dissolved when notice is given by one or more partners to the other(s), unless there is a contrary provision in the partnership agreement. It could, for example, include a provision stating that the partnership can only be dissolved by 12 months' notice in writing.

3. By agreement

The partnership agreement may specify circumstances under which the agreement will be dissolved, such as a majority decision or notice from a specific partner. If there is no such agreement, all the partners must mutually agree to dissolution.

4. Rescission

If a partner has been induced to join the partnership by fraud or misrepresentation, they may treat the agreement as if it had been rescinded or had never existed.

5. By the courts

The grounds for court dissolution are set out in the Partnership Act 1890 and the Mental Health Act 1983. The court may enforce measures under the 1983 Act if a judge decides that the partnership must be dissolved because one of the partners is incapable of managing their own affairs due to permanent incapacity.

Under the Partnership Act 1890, the court may dissolve a partnership:

- When a partner becomes permanently incapable of performing their part of the partnership contract.
- When a partner's conduct is believed to prejudice the business, even when the prejudicial conduct has nothing to do with the partnership. A conviction for dishonesty, for example, would be likely to be regarded as prejudicial conduct in the case of many professional partnerships.
- When a partner wilfully or persistently breaches the partnership agreement, or conducts themselves so that it is not reasonably practicable for the other partner(s) to carry on in the business with them. A small but persistent breach of the agreement may be sufficient for the court to order dissolution, as the trust between the partners will have broken down.
- When the business can only be carried on at a loss. This provision can't be used to end temporarily loss-making partnerships. The partnership must be incapable of ever running at a profit.

- When circumstances are such that dissolution is 'just and equitable'. Examples of circumstances that meet these criteria include refusal to meet on matters of business, persistent quarrels between partners, or such animosity between them that reconciliation is ruled out.
- When assaults or unjustified allegations of misconduct by another partner would justify dissolution.

Consequences of dissolution of a partnership

There are various consequences that arise from the dissolution of a partnership, as follows:

- A partner or partners may be appointed to wind up the business. However, the authority of the partners can be removed by the appointment of a Receiver or a manager - a step that may be taken to ensure court supervision of the dissolution.
- Partners are entitled to publicise the dissolution and inform others by advertising in the London, Edinburgh or Belfast Gazettes (www.thegazette.co.uk).
- Partners are entitled to have the property owned by the partnership used to pay the business' debts and to have surplus assets distributed to the partners after their own liabilities to the business have been deducted.
- Premiums paid to enter the partnership are not normally repayable, but may be if, for example, the partnership was set up for a fixed term and then dissolved early.
- In the case of rescission, the partner rescinding remains liable for the business contracts to third parties, but is entitled to an indemnity from the guilty partner(s).
- An account of post-dissolution transactions must be kept by the partnership.

The Insolvent Partnerships Order 1994 (as amended) provides a code for the winding up of insolvent partnerships in cases of both voluntary and ordered administrations.

Tax implications

Partnerships are transparent for tax purposes. This means that the activities of the partnership are treated as carried on by the individual partners and not by the partnership as a body. Partners are taxed separately on their share of their profits or granted tax relief on the losses of the partnership as though derived from a separate trade or profession carried on by each partner as a sole trader.

A nominated partner is responsible for filing a partnership tax return on behalf of all of the partners, showing the profits of the partnership. The return must show details of the profit-sharing arrangement in force for the accounting periods covered by the return.

The partnership return is subject to the same self-assessment enquiry procedures that apply to individual returns.

Trade will not necessarily cease at the date of dissolution, and the exact point at which the partnership stops trading may be difficult to determine. If a partnership continues to trade after a partner's death or retirement, there may be a deemed discontinuance of business, accompanied by the right to treat the business as continuing. This will need to be discussed with an accountant and lawyer when the partnership agreement is being drafted.

If the business has lost money in its last year, the partners will be able to offset this against earlier profits when calculating the final tax bill.

When business ceases, assets qualifying for capital allowances are deemed to be disposed of and immediately re-acquired at market value. Balancing allowances may be claimed if the market value is less than the written-down value. A balancing charge will be made if the market value is greater than the written-down value. (See BIF243, An Introduction to Tax Allowances for Capital Expenditure.)

On dissolution, the business' assets will be realised and the sale will be treated in the same way as normal disposals. Special rules apply when assets are distributed to partners.

This is a complicated area of business and partners should always seek professional advice about the tax implications of dissolving a partnership.

Distribution of assets and adjustment of accounts

Post-dissolution losses are paid first out of profits, then out of capital and, if necessary, by individual partners in proportion to their entitlement to a share of profits.

Assets are distributed in the following order:

- To pay the debts and liabilities of the business to non-partners (any deficit must be made up by the partners according to their profit-sharing ratios).
- To pay each partner proportionally what is due in respect of loans to the partnership.
- To pay each partner their due share of capital.
- Any residue should be shared in the proportion in which profits are normally shared.

Dissolving a Limited Liability Partnership

The members of an LLP can apply to the registrar at Companies House for the LLP to be struck off the register and dissolved, for example if the LLP is dormant or not trading, if the members wish to retire and there is nobody to replace them, or if the number of members has fallen below the statutory minimum of two for more than six months, meaning that the remaining member could be personally liable for all the LLP's debts. However, even if the LLP is struck off and dissolved, creditors could still apply for it to be restored to the register.

There are certain circumstances in which an LLP cannot be struck off and dissolved. For example, if within the previous three months it has changed its name, traded, sold the stock it would have traded with, or if it is the subject (or likely subject) of insolvency proceedings or a compromise agreement with creditors.

Before applying for dissolution, all members, employees and creditors of the LLP must be informed, together with any other interested parties such as HM Revenue & Customs (HMRC) and pension fund trustees or managers.

After dissolution, any assets of an LLP are passed to the Crown because the assets no longer have a legal owner, and the LLP's bank account will be frozen.

Go to www.gov.uk/government/publications/limited-liability-partnership-strike-off-dissolution-and-restoration for more information about dissolving an LLP.

Hints and tips

- If a partner resigns, dies or goes bankrupt and there is no Deed of Partnership or partnership agreement, the Partnership Act 1890 will apply, under which the partnership will be dissolved.
- It should be agreed in advance between all partners how the partnership should adapt to a particular event. For example, on the retirement of a partner, will their share of the business be transferred to the other partners or will the partnership be dissolved?

Further information

BIF028 Setting up in Business as an Ordinary Partnership

BIF032 Choosing the Right Business Legal Structure

BIF365 An Introduction to Limited Liability Partnerships (LLPs)

Books

'Partnership Law'

Geoffrey Morse

2010

Oxford University Press

'Limited Liability Partnerships Handbook'

Paula Smith

2012

Bloomsbury Professional

Useful contacts

HM Revenue & Customs (HMRC) is the government department responsible for the collection of tax. It provides information and advice to individuals and business owners, including those in a partnership.

Tel: 0300 200 3300

Website: www.gov.uk/government/organisations/hm-revenue-customs

Companies House provides registration and filing services for companies and limited liability partnerships, as well as useful leaflets and information.

Tel: 0303 123 4500

Website: www.gov.uk/government/organisations/companies-house

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