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Partnership and Capital gains: Calculation

Capital Gain Calculation

In general, Capital Gain/loss = Sale proceeds (-) Cost of asset (-) Cost of Improvement.

A similar concept is applied while calculating the capital gain/loss in case of partnership also.

Calculation of disposal proceeds

1. Disposal of interest in an asset belonging to partnership

A. To an outsider

The actual sale proceeds less incidental costs of selling shall be divided amongst all the partners on the basis of their profit sharing ratio.

Disposal proceeds = Actual sale proceeds less incidental costs of selling * Partner's share in partnership

Example: A and B are two partners having equal share in the partnership. They decide to sell a machine of their partnership business to Mr. Z for £2,000 and for this they incurred an advertisement fee of £200. Now the disposal proceeds for each of the partner will be
(£2,000-£200)/2= £900

B. To other partners in the partnership

The disposal proceeds shall be equal to the losing partner's share in the balance sheet value of the asset(s).

Disposal proceeds = Balance Sheet Value of asset * Partner's share in partnership

Example: A, B and C are three partners in the partnership. All have equal interest of 33.33%. C decides to leave the partnership. As on that date the balance sheet,value of the assets was as follows:

Asset	Value
Property	£300,000
Machinery	£150,000
Goodwill	£30,000

Now when C resigns, the disposal value for C shall be as follows:

Asset	Value
Property	£300,000 * 33.33% = £100,000
Machinery	£150,000 * 33.33% = £50,000
Goodwill	£30,000 * 33.33% = £10,000

[Note: This rule may not apply in following situations:

- If disposing partner has received actual consideration to the other partners. In that case, ask HMRC or your tax adviser.
- If disposing partner and the other partners are connected persons, for example, father and son. In that case, ask HMRC or your tax adviser.]

Calculation of cost of asset

2. Disposal of interest in an asset belonging to partnership

A. To an outsider

If the asset was bought by partnership:

- After 31 March 1982, the cost of asset for you will be your share of the original cost of buying the asset, plus any incidental expenses for buying the same.

- On or before 31 March 1982, the cost of asset for you will be your share of the market value of the asset at that 31 March 1982.

B. To other partners in the partnership

The cost of acquisition to the acquiring partners shall be such partner's share in the balance sheet value of the asset(s).

Example: A, B and C are three partners in the partnership. All have equal interest of 33.33%. C decides to leave the partnership. As on that date the balance sheet, value of the assets was as follows:

Asset	Value
Property	£300,000
Machinery	£150,000
Goodwill	£30,000

Now when C resigns, the disposal value for C shall be as follows:

Asset	Value
Property	£300,000 * 33.33% = £100,000
Machinery	£150,000 * 33.33% = £50,000
Goodwill	£30,000 * 33.33% = £10,000

Suppose A and B continue to be equal partners after C's resignation so the cost of acquisition for each of them would be Property £50,000, Machinery £25,000, Goodwill £10,000.

[Note: This rule may not apply in following situations:

- If acquiring partner has given actual consideration to the other partners. In that case, ask HMRC or your tax adviser.
- If acquiring partner and the other partners are connected persons, for example, father and son. In that case, ask HMRC or your tax adviser.
- If the asset was acquired by the partnership on or before 31 March 1982.]

Transfers at balance sheet value

In the examples stated in case 1(B) and 2(B), you must have observed that the figure for both disposal consideration and acquisition cost are actually same. The disposal proceeds for one partner actually sum of cost of acquisition for remaining partners. This is because the transfer is taking place at balance sheet values.

This will be the case if the assets have not been revalued since you acquired your interest in them.

Example,

A, B and C entered into a partnership in year 1999. The profit sharing ratio was fixed at 30:30:40. The balance sheet value of assets as on that date was:

Asset	Value
Plant	£600,000
Machinery	£400,000

Situation 1: ASSETS AT BALANCE SHEET VALUE

In 2002, D enters the partnership. C gives up half of his share in favour of D. New partnership ratio is 30:30:20:20. Since there was no change in balance sheet value so, C will use 20% (being half of 40%) of the value of assets as both his cost of acquisition and cost of disposal i.e.

Asset	Value
Plant	£600,000 * 20% = £120,000
Machinery	£400,000 * 20% = £80,000

In such situation C makes therefore makes neither a gain nor a loss as cost of acquisition = disposal value.

Situation 2: ASSETS ARE REVALUED

In 2002, D enters the partnership and the assets have been revalued by now as under:

Asset	Value
Plant	£900,000
Machinery	£300,000

C gives up half of his share in favour of D. New partnership ratio is 30:30:20:20. In such case gain/loss will arise as follows:

a. **Plant**
   Disposal value = £900,000 * 20% = £180,000
   Cost of acquisition = £600,000 * 20% = £120,000
   Capital Gain = £60,000

b. **Machinery**
   Disposal value = £300,000 * 20% = £60,000
   Cost of acquisition = £400,000 * 20% = £80,000
   Capital Loss = £20,000

Thus when assets are revalued, capital gain/loss arises.

[Note: Transfers of interests between partners take place at balance sheet/revalued value unless actual consideration is paid.]

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