

Fact sheet: Partnerships – allocation of profits

In the absence of a formal partnership agreement, Inland Revenue can reallocate income or losses between partners in a family partnership if the profit allocations are not reasonable.

In determining whether the remuneration or share in profits is, reasonable, the nature and extent of the services rendered, the value of the partners' contributions to capital or provision of services and any other relevant matters are considered.

In so doing, Inland Revenue have regard to hourly rates paid by employers in the particular industry or trade. It must be stressed that these are applied only as a guide. Each case is viewed on its own facts.

Where Inland Revenue consider the remuneration, salary, share of profits or other income payable for the benefit of the partner to be unreasonable, or they consider the share of losses to be unreasonable, they may reallocate the income or losses in a way they do consider to be reasonable.

However, the situation is different when the partners are employed under a properly executed employment agreement, or where there is a properly executed partnership deed.

A valid contract of employment or partnership deed is one where:

- The contract is in writing and is signed by all the parties
- All the parties are aged 20 or more at the time of signing
- Each party to the contract has real and effective control of the income to which he or she is entitled under the contract.
- Each party to the contract has real and effective liability for the share of losses to be borne by him or her under the contract; and
- The remuneration or share of profits of the relative is not of such an amount that the transaction constitutes in whole or part a gift.

If Inland Revenue do not consider the contract to be valid, they can direct the remuneration or share of profits to be reallocated.

Our recommendation

In deciding whether a reallocation of income is justified, Inland Revenue apply a formula to partnership income.

As this formula is relatively complex, we suggest you seek detailed advice from us on the likely consequences of the reallocation of income in your circumstances.

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Important: Clients should not act solely on the basis of the material contained in this article. Items herein are general comments only and do not constitute nor convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. This article is issued as a helpful guide to our clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval.