EMPLOYMENT (EMPLOYEE) V SELF-EMPLOYMENT (PARTNERSHIP)

There are a number of key tax and legal differences to consider when your status changes from that of an employee to becoming a partner in a partnership.

The following table highlights some of the key differences.

EMPLOYMENT (EMPLOYEE)	SELF-EMPLOYMENT (PARTNERSHIP)
The individual (employee) will pay income tax and National Insurance Contributions (NIC) on their earnings received from their employer.	The partner will pay income tax and National Insurance Contributions (NIC) on the taxable profits allocated to them from the partnership.
Income tax rates The same income tax rates that apply to employment income apply to profits from a partnership.	
As an employee, you are taxed on your employment income when is it paid to you, during the tax year, i.e. on a paid basis.	As a partner, you are taxed on the profits that are allocated to you, during your accounting year. Generally, the profits for a tax year are those arising in the period of 12 months ending with the accounting date in that tax year.* *see 'OPENING YEAR RULES AND OVERLAP RELIEF' section at the end of this document.
As an employee you may have to file a self-assessment tax return with H M Revenue & Customs. To register for self-assessment as an employee you should complete and submit Form SA1.	As a partner you will have to file a self-assessment tax return with H M Revenue & Customs. Form SA401 should be completed by an individual becoming a partner in a partnership, to register for self-assessment and National Insurance contributions.

AS A PARTNER, YOU ARE TAXED ON THE PROFITS THAT ARE ALLOCATED TO YOU, DURING YOUR ACCOUNTING YEAR.

As an employee, you have tax withheld at source from your pay in the form of Pay As You Earn 'PAYE'.	As a partner, PAYE will no longer apply and you will likely fall into the 'payment on account' system. Payments on Account are made twice a year for the current tax year. 1. 31 January (within the tax year) 2. 31 July (after the tax year ends) Each payment is 50% of your previous tax year's tax bill. This will likely not apply in year one.
National Insurance Contributions (NIC). As an employee, you are subject to Class 1 NIC. The rates for the year 2016/17 are: 1. If you earn more than £155 a week and up to £827 a week, you pay 12% of the amount you earn between £155 and £827. 2. If you earn more than £827 a week, you also pay 2% of all your earnings over £827. Your contributions are deducted from your wages by your employer.	National Insurance Contributions (NIC). As a partner, you are subject to pay two classes of NIC, Class 2 and Class 4. The rates for the year 2016/17 are: 1. Class 2 NIC is paid at a flat rate of £2.80 a week (2016/17) if your earnings are over £5,965 in the year. 2. Class 4 NIC is paid as a percentage of your annual taxable profits - 9% on profits between £8,060 and £43,000, and a further 2% on profits over that amount, (2016/17). Class 2 and 4 NIC payments are due on; 1. 31 January 2. 31 July The same as a Self-Assessment tax bill.
The company/business is a separate legal entity to the employees.	The individual partner is the business, you may not have a separate legal entity.

AS A PARTNER, PAYE WILL NO LONGER APPLY AND YOU WILL LIKELY FALL INTO THE 'PAYMENT ON ACCOUNT' SYSTEM.

AS AN EMPLOYEE, YOU ARE SUBJECT TO CLASS 1 NIC.

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OPENING YEAR RULES AND OVERLAP RELIEF – Self-employment (Partners) only

Opening year rules

The first year an individual becomes a partner they are subject to the opening year rules, this falls into two stages:

1. The UK tax year in which a partner joins the partnership ("Year 1")
2. The following UK tax year. ("Year 2")

For the following example, we will assume an accounting year end of 31 December 2016.

Year 1

This year is always based on the actual income that arises between the partner joining the partnership and the April 5th following that date. Thus if a partner joins the partnership on 1 January 2016, this involves a commencement in the 2015/16 UK tax year. Profits attributable to the part of the tax year when an individual becomes a partner (1 January 2016 to 5 April 2016) will be calculated by prorating the income for the partnership accounting period year ended 31 December 2016.

Year 2

A partner will then be taxed during the second tax year on their share of profits attributable to the first twelve months that they are a partner. To continue with the example of an individual who was admitted to the partnership on 1 January 2016 and using a year-end of 31 December, the joiner's first twelve months as a partner is the period 1 January 2016 – 31 December 2016.

You will see that the profit for the period January 1 2016 to April 5th 2016 was also assessed to tax in "Year 1" and they are again assessed to tax in "Year 2", meaning three months of profit is essentially taxed twice. This is known as overlap profits.

Year 3

Once a partner has gone through the first two years they will be subject to the current year rules. They will now be subject to twelve months' worth of profit in each tax year going forward, this being the twelve month period ending within the relevant UK fiscal tax year.

OVERLAP RELIEF

Overlap profits, those profits taxed for a second time in year two, are carried forward on a partners tax return to offset against income at a later date; unfortunately there is no tax relief available for overlap profits until the tax year in which either of the following occurs:

1. The partnership ceases to trade.
2. The partner retires/leaves the partnership.

THE FIRST YEAR AN INDIVIDUAL BECOMES A PARTNER THEY ARE SUBJECT TO THE OPENING YEAR RULES...

... THOSE PROFITS TAXED FOR A SECOND TIME IN YEAR TWO, ARE CARRIED FORWARD ON A PARTNERS TAX RETURN...

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