BUSINESS GUIDE SERIES:

PARTNERSHIP AGREEMENTS

DEFINITION

A partnership is the relationship which exists between persons carrying on a business in common with a view to profit. It involves an agreement between two or more parties to enter into a legally binding relationship and is essentially contractual in nature.

Partnership law derives both from case law and from statute law. The relevant legislation is to be found in the Partnership Acts 1892 (NSW). This area of the law has been described as a special type of agency. The main reason for this is that partners, when acting in the course of the partnership business, are acting as agents for one another: see *Lang v James Morrison & Co Ltd* (1911) 13 CLR 1 at 11.

Tax Implications

The ATO views a partnership as an association of people who carry on a business as partners or receive income jointly. A formal partnership agreement is common, but it is not essential for establishing the existence of a partnership. Each of the partners pay tax on the share of the net partnership income they each receive. This is because a partnership is not a separate legal entity and doesn't pay income tax on the income it earns.

Determining when a partnership exists

Section 1 of the Partnership Act provides that three elements must be satisfied in order to establish the existence of a partnership:

- The carrying on of a business;
- in common;
- with a view to profit.

If one of these elements is missing, the relationship is not one of a partnership.

Partnerships share income and losses

If you operate your business as a partnership, control or management of the business is shared. This means that income and losses are shared among the partners.

Each partner is responsible for the debts of the partnership, even if you did not directly incur or cause the debt.

ADVANTAGES

- They are relatively easy to establish and with more than one owner the ability to raise capital is increased, for example, borrowing capacity may be greater.
- Partnerships offer employees motivation to commit to a business by providing an incentive to become a partner.
- Partnership combines complimentary skills of two or more people, increasing knowledge, skills and contacts.
- Partners benefit from a direct distribution of profits, shared liabilities and contributions to capital.

DISADVANTAGES

- A significant disadvantage includes joint and, in some States, several liability for partnership debts.
- Business partners are jointly and individually liable for the actions of the other partners even if they didn't authorise the transaction.
- Profits must be shared with others even if one partner puts in less time or effort than the other.
- Decisions are shared by partners, which has the potential for disputes and disagreements to occur.

The importance of a Partnership Agreement

Although it is not essential to have a partnership agreement to establish the existence of a partnership, it is certainly an important step to take in formalising the arrangement. A partnership agreement will explicitly set out:

- How the business will be financed and managed
- Who will do what work;
- How new partners can join the partnership;
- How the profits will be distributed;
- How decisions will be made for the partnership;
- What happens if a partner retires, needs to be removed, or dies; and
- What happens if one or both partners want to dissolve the partnership, sell the partnership or needs to appoint a receiver.

Gateway Tower, Level 19
1 Macquarie Place
Sydney, NSW 2000

Phone: +61 2 8075 4699
Direct: + 61 9195 1310

Email: info@silberstein.net.au
Website: www.silberstein.net.au