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## Partnerships

Partnership involves two or more partners carrying on a business in common with a view to a profit. If these criteria are met then you are operating as a partnership and different legal rules apply than for a sole trader or a company. The Partnership Act sets out much of the law about partnerships, although it may be overridden on particular matters by the terms of a formal partnership agreement.

### What is partnership?

Partnership generally involves a contract between partners to engage in a business in order to make a profit. Ideally, the aim is that two or more people acting together should be able to achieve more than the sum of what those people could achieve by acting individually.

In general, each partner contributes either assets, skill, or labour, although a partner may contribute nothing and still have the rights of a partner.

### Formation

There are no formal requirements for the formation of a partnership, therefore arrangements between parties must be closely examined to determine whether a partnership exists.

Unlike a company, an ordinary partnership does not need to be registered. However 'special partnerships' (allowing a person to be a partner on terms that their liability to creditors is limited) must be registered with the High Court.

In most cases, the partners will formalise the arrangement between them by entering into a partnership agreement that governs their respective rights and obligations. In the absence of such an agreement, the provisions of the Partnership Act apply to regulate the partnership business and determine profit sharing.

### Effect of partnership

A partnership is not generally considered a separate legal entity from the partners.

Control, authority, and responsibility for partnership decisions are shared (although this may be altered in the partnership agreement). In addition, the partners become jointly and severally liable for the debts of the partnership incurred while they are a partner, and every partner is an agent of the other partners within the scope of the partnership.

A partner could, however, limit their liability by establishing a company to act as the partner in some circumstances.

### Relationship between partners

At common law, a partnership is a fiduciary relationship in which partners are required to act fairly and in good faith towards each other. In addition, the Act, among other things:

- ✦ Requires partners to render true accounts and to provide full information of matters affecting the partnership; and
- ✦ Prohibits partners from making private gains by reason of their membership of the firm. When a partner competes with their firm without the consent of the other partners then profits made from the competing business must be paid over to the firm.

## Partners and third parties

Every partner is an agent of the partnership and of the other partners in regard to partnership business. This means that any act done by a partner in carrying on the business in the usual way will normally bind the partnership and the other partners, unless it can be proven that the partner had no authority to act in that particular matter and the third party was aware that they lacked authority or did not believe them to be a partner.

## Dissolution

The question of dissolution of a partnership usually arises when there is a dispute between the partners. The partnership deed will usually set out the grounds for termination of the partnership. The provisions of the Act apply in the absence of any term to the contrary in the partnership deed. These provisions allow dissolution:

- ✦ On expiry of a fixed term;
- ✦ On completion of certain events;
- ✦ By notice from one partner;
- ✦ By death or bankruptcy of a partner;
- ✦ At the option of the other partners where one partner has a charge placed on partnership property for a personal debt; and
- ✦ Where the partnership business becomes illegal.

In addition, a partner can apply to the court for dissolution on the grounds (for example) of insanity or incapacity of a partner, or because it is just and equitable that the partnership be dissolved.

## Profits and assets

The partners can agree as to the distribution of profits/losses made by the partnership. In the absence of any agreement, the Act provides that partners share equally in the profits/losses.

On dissolution of a partnership, unless the partnership deed provides otherwise, the Act lays down the distribution rules to be followed. All

losses, capital or otherwise, shall be paid first out of profits, then out of capital, and finally by the partners in proportion to their respective profit shares. The Act also provides that assets shall be applied in the following order:

- ✦ Paying debts to third parties;
- ✦ Repaying partners' advances;
- ✦ Repaying partners' capital; and
- ✦ The residue in proportion to the partners' profit shares.

## Tax issues

A partnership is not a separate legal entity and does not, itself, pay income tax.

Instead it distributes the partnership income to partners and each partner is taxable on their share at their marginal tax rates. Despite this, a separate tax return must be filed.

For GST purposes, a partnership is treated as a separate legal entity. The partnership must register for GST purposes and file GST returns if the annual turnover exceeds or is likely to exceed \$40,000. Partners who incur expenditure on behalf of the partnership cannot separately register for GST purposes.

## Finally

Talk to us before deciding on using a partnership as your preferred business structure. It is important that partners formalise arrangements between them and have confidence and trust in each other, because the actions of one partner may cause the partnership business to become insolvent. All partners will then become individually liable for the entire amount of the remaining business debts and legal liabilities.

## See us first

- ✦ Before making any financial decisions.
- ✦ To assist you in meeting the necessary legal or financial requirements.
- ✦ If you consider that any of the issues contained in this fact sheet may affect you.

## Disclaimer

Important: This is not advice. Clients should not act solely on the basis of the material contained in this fact sheet. Items herein are general comments only and do not constitute or 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. We believe the contents to be true and accurate as at the date of writing but can give no assurances or warranty regarding the accuracy, currency or applicability of any of the contents. This fact sheet is made available to our clients as a helpful guide for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval.