



FACTSHEET

Partnership Agreements

Partnership or Company?

Going into business with another person or persons is typically by way of partnership or limited company.

Partnerships do not have a separate legal existence – companies do. Liability of partners is unlimited – liability of companies is limited. Taxation of partners is Schedule D assessed on the previous financial year – taxation of companies is through Corporation Tax.

Partnerships require little formality – usually a written agreement. Companies have to be registered at Companies House and file specified documents including annual accounts, which may be accessible by the public.

To decide which structure suits the business best advice from your solicitor or accountant may be beneficial.

This leaflet will concern itself with partnerships only.

Partnership Agreement

A written Partnership Agreement is strongly recommended. Although statute (Partnership Act 1890) provides a comprehensive framework for the management of partnership business, this can in many instances be overridden by the specific agreement of the partners. Putting into an agreement what the partners have specifically decided tends to produce a more reliable and stable business arrangement.

Date of Commencement

Has the partnership already begun or will it begin on the date of the Agreement or a future date? It is important to make this clear since the partners' obligations run from that date.

Duration of Partnership

This may be for a fixed period of time, or for the duration of a specific project, or for the joint lives of the partners, or on an indefinite basis, until brought to an end in the way the agreement – or statute- specifies. The indefinite period with specific termination provisions is the most common.

Nature of Business

This must be specified. [Partners also need to consider whether they wish to

remain partners even if the business which brings them together becomes unviable; will they diversify or dissolve?]

What proportion of partners will be able to vote for a change, or will this need to be unanimous?

Name

A partnership is not a separate legal entity; but its trading name identifies it and must not be misleading to the public. It must also conform to the Business Names Act 1985 and regulations made under it; besides avoiding certain words in the partnership name, partners must ensure that any stationery lists the partners' names or if 20 or more partners a note of the place of business and the fact that a list can be seen there.

Partners' Obligations with the Firm

The duty of good faith owed by partners to each other and the firm is behind many of the specific obligations which may be set out in a Partnership Agreement, e.g. whether partners devote their whole time to the firm or have private business interests, whether partners need to maintain specific professional qualifications, leave entitlements, management responsibilities, instances where partners can or cannot make decisions without consulting other partners, indemnity, expenses incurred on behalf of the partnership, duty not to compete after dissolution.

Partners' Position Re. Third Parties

Generally, according to Section 5 of The Partnership Act 1890, every partner is an agent of the firm and the other partners for the purpose of the business of the partnership. Authority to act as agent runs from the commencement date (see above) to termination (see below); but third parties without notice of any change can still hold the partnership bound by acts of a partner purportedly on behalf of the partnership. More generally, anyone who is "held out" as a partner can also become liable as such.

Debts contracted by the partnership are, generally, the joint liability of the partners. Partners who retire or die remain liable personally or through their estates for debts or obligations incurred before retirement or death, unless released by novation. New partners can take on liability for the partnership's debts also by novation. "Novation" means reaffirmation or reinstatement of a liability or an agreement so that in future it can be relied on, on the new terms.

Partnership Property

As a partnership is not a separate legal entity it cannot hold property in its own name, but only in the names of the individual partners.

Generally according to Section 20 of The Partnership Act 1890 "all property and rights and interest in property originally brought into the partnership or acquired ... on account of the firm or for the purposes in the course of partnership business are ... partnership property".

Capital

The proportion of capital contributed by the partners should be clear. If partners together create a new firm, the capital they introduce at the outset is easily ascertained. If a new partner enters an existing firm or partnership, the capital he/she introduces has to be assessed by reference to the assets liabilities of the firm. The accounting principles on which this is done need to be clear.

Share of Profits/Drawings

The Partnership Act 1890 stated that unless the partnership agreement specifies otherwise, profits are shared equally between the partners. The partnership agreement should specify share of profits (which may or may not be 50:50) and deal with drawings. Do partners draw a regular amount, are they permitted to draw the whole of their share of profits or are these an accretion to capital? How should losses be borne? To what extent does prolonged absence of a partner affect their drawings?

Accounts/Taxation

Partners must keep accounts. It is usual to specify the partnership bank and accountant in the partnership agreement.

Tax is by way of Schedule D income tax on the individual partners. Tax is paid on the profits of the preceding financial year. If a loss is made, the reduction in tax benefits the firm in the following year. Thus, in a typical start-up scenario, when the firm is not yet running at full profitability, it will be taxed twice on its first year, typically leading to a relatively low tax bill until the third year. Advice should be taken from your accountant to maximise this and other tax benefits.

Termination

The Partnership Act 1890 provides that a partnership ends when one partner dies. This is not always appropriate. Specific provisions should be incorporated in the partnership agreement to reflect the partners' preferred arrangements. A partnership may be dissolved on the happening of certain events, which may or may not include death, bankruptcy, retirement, or expulsion.

Limited Liability Partnerships

These have been possible since 2001. They share the characteristics of companies and partnerships.

For more information, please contact us at the address below.

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