

Partnerships - Have it in writing

A common form of trading or engaging in business is through a partnership. Although it is not a legal requirement that partnerships start off with a written agreement, it is strongly recommended that partnerships have, at the very least, a basic written agreement.

The legal definition of a partnership is that it is a relationship which exists between persons carrying on a business in common with a view to profit. A partnership relationship is therefore contractual in nature involving two or more parties entering into a legally binding relationship. The law of partnership derives from case and statute law, and as discussed below, has been extended by our tax laws.

In Victoria, the *Partnership Act 1958* governs partnerships generally including those partnerships that operate without written partnership agreements. A partnership can be a general partnership (where all the partners are equally responsible for the management of the partnership business and also have unlimited liability for its debts and obligations) or a limited partnership (where the liability of one or more partners for the debts and obligations of the partnership business is limited) or an incorporated limited partnership (a special type of limited partnerships usually used in special projects).

In Victoria, pursuant to the *Partnership Act 1958*, limited and incorporated limited partnerships must be registered with Consumer Affairs Victoria.

Reasons to cast partnerships in writing

There are advantages and disadvantages of choosing a partnership structure over other forms of business structures such as a company, joint venture, unit trust etc. However, this will not be considered in this article as the merits or demerits of a partnership gives rise to an entire topic itself.

As mentioned above, although a verbal general partnership agreement can be just as legally binding as a written one, verbal agreements may be difficult to prove. Additionally, people can have different memories of what has been said and may have differing interpretations of what was said. Verbal communication can sometimes be misleading and confusing. Therefore, as far as possible, it is best practice to have written partnership agreements especially where the partnership is of special significance.

Additionally there are certain trigger events that cause a partnership to dissolve at law, such as a partner dying, becoming bankrupt etc. Therefore, so that the partnership is able to be control its destiny and make its own decisions about its continuity, a written agreement is invaluable in such situations to counter what would otherwise happen by default.

A partnership can be seen as being a special type of agency as each partner is agent and principal of the others and owes fiduciary obligations to the others. This means partners can bind each other and be bound by the actions of their partners. This means it is crucial the roles, understanding, and relationship of the partners are documented in writing to regulate the parties relationship and that of the partnership with third parties.

Another important reason for partnership agreements to be in writing is because partnerships give rise to varying tax consequences even though a partnership is essentially a 'look-through' tax entity and doesn't itself pay taxes on its income (although it is required to file returns). For CGT purposes, again the look-through status of the partnership means it is the partners that are deemed to own a portion of a CGT asset and are taxed accordingly.

It must also be noted that for income tax purposes, the definition of a partnership extends the meaning of "partnership" to that in the *Partnership Act 1958* in that for tax purposes where the parties are in "receipt of ordinary income or statutory income jointly" they will also be considered to be a partnership. Such "tax law partnerships" should also give parties pause for thought. Therefore, a written partnership agreement is useful and recommended to create greater tax certainty and flexibility in the ways profits are distributed.

Legal advice

It is a good idea to seek legal advice if you are considering a partnership or are in one without a written partnership agreement.

Please feel free to contact our office on 8555 3895 to make an appointment to see a lawyer.

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