Guide: Partnerships

Partnerships have long been an effective way of conducting business operations, either on a husband and wife basis or on an “arm’s length” basis.

In the normal partnership, the liability of partners is unlimited and extends to their private property as well as to the partnership assets.

The taxable income of the business is split between the partners and the partners pay tax at their individual rates on their partnership income. Husband and wife partnerships are reasonably common.

Liability

A partnership is not a legal entity separate from the individual partners. The members of the partnership are therefore personally liable for all partnership debts. Since partners are legal agents for each other, it is important to choose your partner or partners carefully.

In the normal partnership, the liability of partners is unlimited. Liability extends to their private property as well as to the partnership assets.

Under law, partners are jointly (together) and severally (individually) liable for the debts incurred in their business. They are liable for all the partnership’s debts and obligations of a contractual nature. The liability is not simply for the proportionate share held. Many a partner has found him/herself meeting 100% of the debts because the other partners were incapable of contributing.

Limited partnership

However, in certain circumstances, it may be possible to register as a limited partnership. A limited partnership provides limited liability for “limited partners”, although they cannot participate in the management of the business. Limited Partnerships are a separate legal entity that retain the flow through tax treatment of a partnership. A requirement of Limited Partnerships is that there is at least one limited partner (a passive investor) and a general partner (who manages the business and is liable for the debts and obligations of the partnership). Accordingly, this structure may be suitable for venture capital investors providing capital to New Zealand based ventures.

This guide deals generally with partnerships rather than limited partnerships. If you would like more information about limited partnerships contact our office so we can go through this with you.

Obligations

Partners have an obligation in law to keep their fellow partners fully informed and to use information gained in the course of the partnership’s business for the benefit of all partners.

Partnership agreement

A formal contract is not essential. However, it is desirable that every arm’s length partnership has a written partnership agreement, prepared by a solicitor, which sets out the terms and conditions of the partnership and the rights and responsibilities of the partners.

If there is no such agreement — common for husband and wife partnerships — the partnership is governed by the Partnership Act 1908.

What it covers

The parties to a partnership agreement are free to include any details they wish for the running of the business (but use the attached checklist as a guide). It is recommended that copies be held by the partners, their solicitors, accountants, and bank.

Advantages

The advantages of a partnership include:

- relatively low cost of entry
- no significant legal costs, unless a partnership agreement is required
- Income is apportioned to partners according to their share in the partnership as generally documented in the partnership agreement (this can be based not only on the share in partnership assets but also other factors such as partners' performance in partnership business)
- no registration of name required (if trading under your own names)

Disadvantages

On the other hand, the disadvantages include:

- partners are personally liable for all business debts
- partners are personally liable for debts incurred by other partners
- potential for relationship problems
- limited succession assistance

Dissolution

A partnership can be terminated or dissolved in a number of ways.

Normally, the death or bankruptcy of a partner will automatically result in the partnership being dissolved, unless the partnership agreement sets out otherwise.

In certain circumstances, a partner can apply to the court for a winding up order. For example, if one of the partners is of unsound mind, has been guilty of continuous misconduct, or if the business is continuing to run at a loss.

Costs

Solicitors' fees vary tremendously. We recommend that you obtain an estimate from your lawyer.

Partnership Agreement Checklist

	Items to be included	Notes	✓
1.	Names and addresses of the partners		☐
2.	The percentage interest that each partner will have		☐
3.	The name of the partnership		☐
4.	Business Trading Name		☐
5.	Prime purpose of the partnership		☐
6.	The length of time that the partnership will be in existence and/or when a review will be undertaken		☐
7.	The capital and expertise each partner will invest in the business		☐
8.	Whether or not there is a designated interest rate payable on those funds		☐
9.	Details of working partners' salaries and fringe benefits		☐
10.	Details of sharing in profits and how these profits can be drawn from the business by the partners		☐
11.	The management responsibilities of each partner		☐
12.	How decisions are to be made in the event of a tied vote		☐

	among the partners (usually referred to an independent arbitrator)		
13.	Consideration as to how new partners can be admitted and how old partners will resign, retire, or be dismissed. Also, consideration of death or bankruptcy.		☐
14.	How is a withdrawing interest in the partnership to be valued?		☐
15.	Does the withdrawal valuation include goodwill?		☐
16.	If so, how is goodwill to be valued?		☐
17.	Consideration of the circumstances which would dissolve the partnership and the ground rules covering the distribution of assets of the partnership		☐
18.	Bank Account to be opened in the names of the partners		☐
18.	All partners should be authorised to operate the partnership bank account		☐
20.	On all business stationery the names of the partners or the business name should be stated		☐
21.	All accounts with creditors should be in the names of the partners or in the business name		☐
22.	Each partner should have the right to dispose of his/her partnership income as they see fit		☐
23.	Funding of capital expenditure		☐
24.	Frequency of partnership meetings		☐
25.	Frequency of preparation of financial statements		☐
26.	Allocation of partnership responsibilities		☐
27.	Preparation of budgets and cashflow forecasts		☐
28.	Preparation of business plan		☐
29.	Quality assurance system		☐
30.	Systems manual for the business		☐
31.	Treatment of intellectual property brought to the partnership or developed by the partnership		☐
Completed by: ______________________________ Date: ______________________________			
Checked by: ______________________________ Date: ______________________________			

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