Set up as a partnership

If you are thinking of going into business for yourself, one of the most important decisions will be choosing the correct legal structure for your business. In today's competitive business environment, your choice of business structure could affect your business' long term success.

The most common structures for small business are sole trader, partnership, company and trust. Each structure has important differences in relation to tax liability, personal financial liabilities and set-up costs. The legal structure that you choose for your business will affect:

- Who legally owns your business.
- The legal responsibilities and rights of the owner/s.
- How effectively your structure will protect you from liabilities or legal actions.
- The types and amount of tax that the owners and the business are liable to pay.
- A number of other business issues such as how regulated your business activities will be.

For specific advice about choosing the best legal structure for your business, it is recommended that you consult with your solicitor and accountant before making a decision.

What is a partnership?

A partnership is a relatively simple, informal and inexpensive way to structure your business. It involves two or more co-owners participating together in a business with an intention to make and share profits and an understanding that these co-owners (or partners) act on behalf of each other in the business.

Four important elements in a partnership are:

1. **Identification of the partners with the business** - Like the sole trader structure, a partnership is not an entity separate from its operators. A partnership is an association of people who carry on business in common.

2. **Unlimited personal liability of the partners** - You and your partners may set limits on how much each of you will be liable for between yourselves, but legally each participating partner's liability to creditors is unlimited. This means that all partners in a partnership are collectively responsible for all business debts - in this respect, the partnership structure is worse than being a sole trader because as a partner you are not only liable for your own acts, but also for the acts of all of your other partners, over which you may have little or no control.

3. **Non-transferability of partners' interest** - Partners cannot transfer their share to someone outside the partnership unless the other partners agree.

4. **The right of each partner to take part in management** - Generally, no change in the nature of your business can be made without the consent of all partners.

Is a partnership right for my business?

A partnership may be the right business for you if:

- You and your partner/s have confidence in each other's abilities, compatibility, honesty and loyalty; and
- If your business is reasonably 'low risk'; or
- You are already a sole trader looking to share responsibility or grow your business.

However, the detailed ownership rules, administrative structure, flexibility, limited liability and tax strategies that you will obtain through other structures such as a company or a trust may be more appropriate if your business is a 'high risk' business or you have any doubts about your partners, despite the additional set up and operational costs and complexities of these other structures such as a company or a trust.

What will be your liabilities as a partner?

If you are considering entering into a partnership, you should be aware of the following liabilities:

1. **Joint and several liability** - Each partner is capable of making all other partners liable by incurring debts in the name of the partnership. Partners are jointly and severally liable, which means that as well as having a shared liability for all of the debts of the partnership, they are also individually personally liable for all debts incurred by or in the name of the partnership.

   In this respect, the partnership structure is worse than being a sole trader because a partner is not only liable with their personal assets for their own acts, but also for the acts of all of their partners, over which a partner may have little or no control.

2. **Contractual liabilities to third parties** - The *Partnership Act 1891* (Cwlth) places joint liability on all partners for the business' debts and obligations incurred during their involvement in the partnership. In some cases, partners can be liable for debts incurred without their knowledge or authority. This means that if your partner contracts with a supplier, you may still be liable for the debt even if you didn't know about it. You (as well as the partner who incurred the debt) can even be sued individually for all of the debt!

3. **Liability for wrongs to third parties** - When partners retire they are still liable for debts and obligations incurred during their time in the partnership unless there is an alternative agreement between the other partners and the people to whom the debts are owed. New partners are not liable for debts or obligations incurred before their arrival into the partnership unless they agree to be so.

4. **Liability to account** - As a partner you are obliged to keep your partners properly informed. For example, if you are doing business outside of your partnership which is seen to be in competition, you are legally bound to inform your partners and may have to share any profits you make.

Do I need a partnership agreement?

The *Partnership Act 1891 (Cwlth)* sets out various rules for the formation and operation of partnerships. However, many of these rules can be varied by a formal written partnership agreement entered into by all the partners. Although it is not required by law, it is highly recommended that you enter into a written partnership agreement with your prospective partner(s). This agreement will be a useful point of reference in the event of disputes between the partners - which make it a valuable, and probably essential, document in any partnership.

The partnership agreement will also assist to ensure that all partners have a clear understanding of their rights, responsibilities and obligations as a partner. The partnership agreement should be reviewed regularly.

How do I draw up a partnership agreement?

The following will provide you with a general idea of what to include in a partnership agreement. There will be other issues that you should include in your partnership agreement to cater for your individual business needs. Your solicitor can assist you in tailoring the agreement to meet your requirements.

Legal	**Financial**	**Personal**
The name of the partnership and its main purpose. How long the partnership will be in existence and when a review will be undertaken.	The capital and expertise each partner will invest in the business and whether or not there will be a designated interest rate payable on those funds.	Names and addresses of the partners. Each partner's stake in the business.
How new partners will be admitted and how existing partners will resign, retire or be dismissed. The ground rules covering death and business closure.	Details of profit sharing and how these profits can be drawn from the business. Consideration of the accounting functions, bank accounts and records.	Details of working partner remuneration (salaries and/or share in profit) and fringe benefits.

Further information

For specific legal and taxation advice, consult with your solicitor and/or accountant. They are able to keep you up to date on changes in the law - which may affect your choice of legal structure for your business.

The following fact sheets provide further information on these issues:

- Business name registration
- Legal aspects of succession planning
- Tax implications of a partnership