

WHY HAVE A WRITTEN PARTNERSHIP AGREEMENT?

WHAT IS A PARTNERSHIP?

The Partnership Act, 1890 describes a partnership as a relationship which exists between two or more people carrying on a business with a view to profit. Partnerships are an important part of business life in Ireland and are beneficial for a number of reasons including accounting, taxation and disclosure advantages over limited companies.

For example, partnerships do not have to go through any registration process to be formed and in a partnership situation there is no obligation to file annual returns publicly. Furthermore, partners will only encounter one taxable event in the form of income tax on their share of the profits while members of a company will have to pay corporation tax on company profits along with income tax on any dividends paid to members. However, unlike a company a partnership is not a separate legal identity. This means that the partners have unlimited liability, unlike directors or shareholders in companies. The downside of this is that each partner is liable for the losses of his co-partner in carrying on the partnership business, even where the other party has defrauded clients of the business.

There are many daily life situations where a business partnership comes into existence, even without the knowledge or intention of the parties. For example, if two or more people decide to open a business and actively carry out business activities together and do not incorporate the business as a limited liability company, they are operating under a partnership, whether they realise this or not.

However, each individual situation must be looked at as a whole in order to determine whether or not a partnership exists, despite what the intentions of the parties might be or label they place on their relationship. Therefore even if two people who own property together and make a profit from it call themselves 'co-owners' rather than 'partners', they will still be in a partnership relationship if they operate with a view to making a profit.

If the partnership is carried on under a name which does not consist of the surnames of the partners, then the partnership must register a business name and publish the names of the partners on the firm's stationery. In the event of a dispute, this may be very important as it may indicate when somebody became or ceased to be a partner.

A partnership may take the form of a 'fixed term partnership' (formal partnership) or a 'partnership at will' (informal partnership). A fixed term partnership exists where

there is an agreement by the partners that the partnership is to last for a specified amount of time. A partnership at will is essentially all other partnerships.

WHY IS A PARTNERSHIP AGREEMENT IMPORTANT?

In many ways a business partnership is like a personal partnership where the people involved need to understand their roles and responsibilities. In business, especially, those understandings should be in writing. A partnership agreement is a written contract between partners in a partnership which sets out the terms and conditions under which the partnership and the relationship between the partners will work. A partnership agreement will typically include clauses relating to:

- The duties of each partner
- The distribution of profits and losses
- The term of the partnership
- How a partner can buy their share of the partnership
- What happens if a partner leaves
- What happens if a partner wants to retire/dies
- How the partnership can be terminated

It goes without saying that a partnership agreement should be entered into at the outset of the relationship with thought given to the various all important 'what happens if' questions. This will help avoid unnecessary problems and unhappy individuals when matters come to a head for whatever reason.

WHAT HAPPENS IF NO PARTNERSHIP AGREEMENT IS IN PLACE?

If no written partnership agreement is in place, it is crucial to understand that the default provisions of the Partnership Act, 1890 will apply. In most cases, the provisions of the Partnership Act, 1890 are regarded as inappropriate for most modern partnerships. However, a written partnership agreement, tailored to the specific needs of the business can exclude these provisions and apply more appropriate terms for the business concerned.

PARTNERS RIGHTS UNDER THE PARTNERSHIP ACT, 1890

Some of the default provisions that apply automatically under the Partnership Act, 1890 are:

- Profits must be shared equally between all partners. This is the case even if contributions to start up the business are unequal. For example, one partner may contribute 90% of the initial capital investment and the other partner 10%, and it may be intended that profits would be shared in that ratio. However, unless otherwise provided for in writing, the profits must be shared on a 50/50 basis.
- No partner is entitled to remuneration or payment for acting in the partnership business. Instead, partners are entitled to share in the profits of the business, the total of which won't become clear until the end of the financial year. If a partner takes regular payments from the business during

the year these are called “drawings”. After profits have been calculated anything owing to an individual partner can be paid over to them. If the drawings exceed the share of profits then any excess should be repaid.

- There is no provision to prevent a former partner from competing with the firm after they leave. For this reason it is common for modern written partnership agreements to include a non-compete clause.
- There is no right to expel a partner irrespective of that person’s conduct. If one partner contributes no time or energy into the business, or if they are negligent or cause a loss to the business, there is no right under the Act to expel that person. The only solution in such a case and in the absence of a written agreement is to dissolve the partnership.
- If a partner dies or becomes bankrupt, the partnership is automatically dissolved. A written partnership agreement can provide that in either of these events, the share of the deceased or bankrupt partner may be purchased by the remaining partners, thus allowing the business to continue without disruption.
- There is no provision for the retirement of a partner. Therefore if a partner wants to retire, then in accordance with the Act the partnership must be dissolved. Again, a written partnership agreement can avoid this scenario by making alternative provisions.
- Any one partner, no matter how big the partnership is, can dissolve the partnership at any time simply by giving notice at a partner’s meeting. In effect, this means that if one partner decides that they no longer want to continue with the business, they can, by giving notice to the other partners, cause the partnership to be dissolved. As in the case of the death or bankruptcy of a partner, a written partnership agreement can provide for this situation by making specific provisions to purchase that partner’s share of the partnership without the necessity of a dissolution.

CONSEQUENCES OF DISSOLUTION OF PARTNERSHIP

A partnership may be dissolved automatically as seen above, or by application to the court. There are a number of specific grounds contained in the Partnership Act, 1890 whereby a court application can be made. The results in either case are the same, in that the business must come to an end, all debts and liabilities paid out of the partnership property and thereafter the capital and balance of profits, if any, are paid out to the partners.

It is important to be aware that if there are insufficient funds to pay creditors then, in the absence of a written partnership agreement to the contrary, each partner will have to contribute equally to those losses; regardless of the contributions of capital by each partner at the outset.

If a partnership business has been operating for some time and has built up a good customer base and goodwill for the business, dissolution can have disastrous consequences. For this reason it is essential that suitable alternative provisions

would be made in the form of a written partnership agreement to avoid the dissolution of a partnership where one or more partners wish to continue with the business.

If you are involved in a business with one or more other persons and have not formed a company, it is extremely important that you would take legal advice in order to determine whether you are in fact trading as a partnership and may require to have a written agreement drawn up to provide for your particular circumstances and to avoid some of the unsatisfactory consequences which are deemed to apply by the Partnership Act, 1890 in the absence of a written partnership agreement.

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