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Partnership Agreements

Why do I need one?

YOUR QUESTIONS... ANSWERED



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While there is no requirement under English law for partners in a partnership to have a written partnership agreement, it can be very useful in clarifying the position to have such a document in place. This can be invaluable for you while you are operating the business and also for your executors after you die in making it clear for them what each person's rights and responsibilities are. The Partnership Act 1890 contains a number of default provisions that apply where there is no written partnership agreement in place, however these default provisions are inadequate to ensure that you and your estate are properly protected.

These provisions cover the following areas:

- **Management of the business;**
- **Holding of property;**
- **Sharing profits and interest on capital;**
- **Introducing new partners and removing partners; and**
- **Dissolution and the distribution of assets post dissolution.**

MANAGEMENT OF THE BUSINESS

In the absence of a written agreement, the default position is that all partners are entitled to take part in management decisions and that the majority rules. There are exceptions to this, for example the introduction of a new partner or changes to the fundamental nature of the business must be agreed unanimously.

If you are intending to leave your share in the business to a family member, then you need a provision in your written agreement that allows you to do this. If you are intending to bring your child into the business to take over from you when you retire or die then again, you need to make sure that you have the authority to do this.

HOLDING OF PROPERTY

The default position is that all property either brought into the partnership or bought with partnership money is deemed to belong to the firm.

If you brought the property into the partnership and therefore it is registered in your name but it has since been used in the course of the partnership, this could result in arguments between your partner and your executors after your death about whether the property is a partnership asset or a personal asset which may end up having to be resolved by costly court proceedings.

SHARING PROFITS/LOSSES AND INTEREST ON CAPITAL

Under the automatic provisions, all partners are considered to have shared equally in profits and been equally responsible for liabilities. No partner is entitled to interest on any capital they have contributed to the firm and all partners are entitled to have access to the accounting records of the firm.

If one partner has contributed a larger share to the partnership, or there is an agreement that one person takes a larger share of the profits to reflect the work they contribute, then without a partnership agreement, this will not be reflected in the way in which the partnership is dealt with after your death and could mean that your beneficiaries get less money than they are entitled to.

INTRODUCING NEW PARTNERS AND REMOVING PARTNERS

The default position is that you cannot add new partners without the unanimous agreement from all existing partners. Furthermore, the automatic position in the absence of a partnership agreement provides that you must have the agreement from all partners to remove a partner. In cases where you have a difficult partner who refuses to act in the best interest of the business or who has behaved in a way that damages the reputation of the business, the other partners cannot remove him if he refuses to go. You could therefore end up in a position where you are stuck with a partner who damages your business until either they voluntarily leave or the partnership comes to an end.

Both during your lifetime and after your death, you want your business to have the highest value possible and as such, it is important that nothing damages or devalues the business in any way. If you wish to leave your share in the business to your child, you would also want to ensure that they are not stuck in a partnership with someone who is difficult to work with or who will cause them problems in any way. It is therefore important to put an agreement in place dealing with these potential issues.

DISSOLUTION

In the absence of a separate partnership agreement that says otherwise, any partner can serve notice on the other partners that he wishes to dissolve the partnership, bringing the business to an end. There is no requirement of a minimum notice period and so one partner could dissolve the business with immediate effect. There is also an automatic provision that states that the exit, death or bankruptcy of any partner automatically dissolves the firm.

Therefore if you want to leave your share in the partnership to a family member to carry on the business after you die, you need a partnership agreement in place to allow for this as otherwise the default position is that upon your death, the partnership is wound up and assets distributed.

DISTRIBUTION OF ASSETS POST-DISSOLUTION

If the partnership is dissolved, then there is a default order in which the assets and liabilities of the business are dealt with. Firstly, all debts and liabilities of the firm are paid. Secondly, the partners who are due to be repaid for any advances made to the business are repaid. Next, any capital due to the partners is repaid and finally any balance is divided between parties according to percentage of profits they are due. If there are only losses then all partners must contribute towards those in accordance with their profit share percentages. In the absence of an agreement setting out profit share percentages, as stated above, these will be equal shares.

If the business is being wound up because your death has brought the partnership to an end, then this could place an erroneous obligation on your executors in sorting this out and could lead to disagreements and disputes with the other partners resulting in difficult court proceedings.

OMISSIONS

The automatic provisions also fail to deal with other important issues that you may want to consider as partners for example restrictive covenants and goodwill.

RESTRICTIVE COVENANTS

When a partner leaves the business, there are no automatic provisions restricting where he can go or what he can do next. The outgoing partner could therefore go to a competitor and take your customers or clients with them or set up a rival business and poach your employees. It is therefore important to have a separate written agreement restricting what the outgoing partner is permitted to do.

If the business forms a significant part of your estate and especially if you are intending for it to continue after you die and to leave your share to a family member or friend, then you need to ensure that its value is as high as possible. All of the above could damage the value of the business and therefore be detrimental to your beneficiaries.

GOODWILL

Under the current legislation, there is no requirement for a goodwill valuation to be done when a partner leaves either through retirement or at the request of the other partners or if a partner dies. You may have contributed significantly to the goodwill of the partnership and so you or your estate could be entitled to a share of this. Without a written agreement in place, you or your estate could lose out on this extra money.

OTHER MATTERS TO CONSIDER

It is therefore advisable to have a separate written partnership agreement in place for your benefit during your lifetime but also for the benefit of your executors and your beneficiaries after you die. Other useful provisions to include in your written partnership agreement include:

- Drawings
- Management of the business
- Time input, holidays, leave and illness
- Holding of property
- Sharing profits and interest on capital
- Introducing new partners
- Removing partners
- Goodwill
- Restrictive covenants
- Dissolution
- Distribution of assets post dissolution
- Dispute resolution

PLEASE NOTE: the above information is a general guide only to assist you in deciding what further action you should consider taking. We do not have specialist knowledge of the Partnership Act 1980 or of company law in general and you would need to see a solicitor who does to advise on this further and advise on how this can work in relation to your specific circumstances. We would be unable to prepare a partnership agreement for you.

OTHER FACTSHEETS AVAILABLE INCLUDE:

- ✓ Wills
- ✓ Shareholder Agreements
- ✓ Property Ownership
- ✓ Personal Injury Trusts
- ✓ Partnership Agreements
- ✓ Life Interest
- ✓ Lasting Powers of Attorney
- ✓ Intestacy Chart
- ✓ Inheritance Tax
- ✓ Disabled Person Trusts
- ✓ Court of Protection
- ✓ Care Home Fees
- ✓ Probate

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