

ISSUES RELEVANT TO THE PREPARATION OF A PARTNERSHIP AGREEMENT

There are a number of legal vehicles which a group of individuals may adopt to effect a common purpose. A Partnership is a commonly adopted vehicle as it has the advantages of simplicity, low set up costs and relatively minimal statutory supervision.

A Partnership is governed by both common law and statute. It is important that a Partnership Agreement is reduced to writing in order to:

- (a) regulate the contractual rights and obligations between the Partners;
- (b) provide evidence for income tax purposes that a Partnership exists;
- (c) overcome the presumption that Partners share equally in the Partnership assets and capital where that is appropriate;
- (d) overcome other unintended consequences which apply under the Partnership Act unless the Partners agree that those consequences are not to apply, e.g. normally the death of a Partner results in the Partnership being dissolved.

The Partnership Agreement should be drafted in the form of a Deed. A Deed has the advantage of overcoming any problem which may arise relating to the absence of consideration.

The terms of a Partnership Agreement for the conduct of an Accounting Practice will vary according to the requirements of the Partners. In each particular case it is suggested that the Partnership Agreement should include or make provision in respect of the following:

1. Parties

The full names and addresses of the Partners should be included. In the case where a Partner is an Accounting Practice Company or the Trustee of an Accounting Practice Trust the full name and address of the Company (and its ACN) or the Trustee should be included. If one or more of the Partners is an Accounting Practice Company acting in its own right or as the Trustee of an Accounting Practice Trust, then special considerations apply, such as, whether a personal guarantee should be obtained from each Practitioner in regard to the obligations of his or her Company pursuant to the Partnership Agreement.

2. Recitals

The recitals are that part of the Deed which set out the scope of the ensuing Agreement. Consequently it is necessary to state any relevant circumstances leading up to the establishment of the Partnership.

3. Type of practice

The Agreement should describe the type of Accounting Practice the Partners desire to carry on. This is important for three reasons:

- (a) a Partner would not normally be held liable for those acts of another Partner which are outside the scope of the Partnership business;
- (b) normally the Partnership Agreement and accordingly the type of practice cannot be altered without the unanimous consent of the Partners; and
- (c) such a provision will help the Partners to determine what income derived by a Partner personally (e.g. Directors' fees) will be considered as Partnership income.

It might be considered appropriate that the Audit Practice is to be conducted by a Partnership and the balance of the Practice is to be conducted by an Accounting Practice Company or an Accounting Practice Trust.

4. Name and place of business

The name and place of the Practice should be stated.

5. Term

It is usual for the term of the Partnership to be either the joint lives of the Partners or a reasonably lengthy period of time such as 50 years.

6. Capital

There should be a statement of the percentage interest held by each Partner in the capital of the Partnership. Where the injection of capital is not money, the property should be reduced to moneys worth.

7. Partnership assets

Unless there is a provision in the Partnership Agreement to the contrary, the law assumes that the Partnership assets are owned equally by the Partners. Consideration must therefore be given to the following:

- (a) the necessity for the provision of a separate lease to the Partnership by any Partner owning the premises at which the Practice is carried on. This lease would contain all the usual provisions contained in any real estate lease such as provisions for escalation of rent, an option for renewal and assignment of the lease; and
- (b) whether any equipment, books, plant, furniture etc is owned by a Partner personally. Are they to become Partnership property, and, if so, for what price and what terms of payment apply? Otherwise, are they to remain the property of the individual Partner and is there anything to be paid by the Partnership for the use of the property?

8. Profits and drawings

The share of each Partner in the profits of the Partnership should be stated. If a Partner is to receive additional remuneration for abnormal efforts, e.g. if he or she plays a larger role in the management of the partnership business, then provision for this extra remuneration must be included in the Partnership Agreement.

Many Accounting Partnerships incorporate the Lock-Step system of sharing profits. The advantages of this system compared to a system based on equal profit shares and payment for the purchase of 'goodwill' by an incoming Partner should be considered.

The Lock-Step system involves a new Partner receiving a smaller profit share than the other Partners for the first few years. For example, the lock-step to a full profit share might occur over 5 years so that in the first year of Partnership the New Partner receives 50% of a full profit share, 60% of a full profit share in the second year of Partnership and so on by incremental 10% increases each year so that from the sixth year the new Partner is on 100% of a full profit share or an equal share of profits with all the other 'full share' Partners.

The entitlement of a Partner to profits and drawings whilst on maternity or paternity leave should also be addressed.

9. Incoming partners

A mechanism may be established to allow for incoming Partners. In such a case consideration will need to be given to the following:

- (a) Debts owing to the Partnership and Work in Progress generated prior to the admission of the new Partner. Is the incoming Partner to acquire a share of these and if so, for what price and on what terms or are they to remain the property of the existing Partners?
- (b) Provision as to appropriation of accounts paid by clients after the commencement of the Partnership where the client owes money for services rendered both before and after the date of admission of the new Partner.
- (c) Payment of any agreed price for the purchase of an interest or share in the goodwill of the Practice. Provision needs to be made as to how the price is to be paid and the payment of interest on any unpaid part of the price.

10. Retirement

For the Partnership to be an ongoing one, provision must also be made for the retirement of Partners. The following matters should be considered:

- (a) retirement age and whether relevant Anti-Discrimination Legislation prohibits age discrimination;
- (b) period of notice of intention to retire;
- (c) the compulsory purchase by the remaining Partners of the share of a retiring Partner including:
 - (i) the price or method of determining the price, including the basis of valuing goodwill;
 - (ii) the terms of payment of the price and interest payable on any part of the price which remains unpaid; and
 - (iii) whether book debts are to be included in the assets purchased or are to be collected and divided between the old Partners.
- (d) provision for the introduction by a retiring Partner of his clients to the remaining Partners.

11. Death of a partner

Consideration should be given to the following:

- (a) The compulsory purchase by the surviving Partners of the share of the deceased Partner and:
 - (i) the price or method of determining the price, including the basis of valuing goodwill;
 - (ii) the terms of payment of the price and interest payable on any part of the price which remains unpaid;
 - (iii) whether book debts are to be included in the assets purchased or are to be collected and divided between the surviving Partners and the deceased Partner's estate;
- (b) The method of financing the payment to the estate of the deceased Partner.

12. Expulsion

It is normal to provide for the right of Partners to expel a Partner in limited circumstances e.g. bankruptcy, repeated breach of the Partnership Agreement and serious professional misconduct.

13. Sickness

Consideration must be given as to what will happen in the event that a Partner is sick for a short or long period.

(a) Short Periods

What period of sick leave is to be allowed? Is the sick Partner to suffer any pro rata loss of profits and drawings and after what time period? Is there an obligation on Partners to take out sickness and accident insurance? Who pays the premiums and owns the policy - the Firm or each Partner?

(b) Long Periods

Can the other Partners exclude the sick Partner from the Partnership and, if so, on what terms e.g. same terms as apply in the event of the death of a Partner? What

period of absence from the Practice is to elapse before such a provision can be invoked?

14. Duties

It is usual for a Partnership Agreement to impose standard duties and obligations; e.g. to be just and faithful to each other, to pay separate debts, to disclose all material information, not to assign or charge a Partnership share or Partnership assets without the consent of the other Partners.

15. Restrictive covenant

The Partners should consider whether a clause is to be inserted in the Partnership Agreement which restricts the future practice of an ex-Partner. The clause should address the following issues:

- (a) Is the restriction to be a total prohibition from practising in a particular geographical area and/or in relation to clients of the Practice?
- (b) What is to be the duration of the restriction?

16. Management

In the absence of a provision to the contrary, each Partner takes an equal role in the management of the Partnership business. In a large Partnership consideration should be given to setting up a management structure to conduct the day to day running of the Practice. Some of the issues which need to be addressed either in the Partnership Agreement or at an administrative level are as follows:

- (a) Payment of expenses.
- (b) Banking arrangements. Who is to sign cheques?
- (c) Keeping of financial records.
- (d) Yearly, half yearly or other periodical accounts.
- (e) Division of profits and periodical drawings on account of profits.
- (f) Motor cars of Partners and registration, insurance and maintenance. Is this to be a Partnership expense or to be the responsibility of each Partner?

- (g) Professional indemnity insurance.
- (h) Leave provisions including:
 - (i) Annual or other periodical recreational leave. Length of time, when and how to be taken. Whether recreation leave is to be allowed to accumulate.
 - (ii) Extended or sabbatical leave for overseas travel, holidays, post-graduate studies etc and for local post-graduate studies. Length of time, when it may be taken, who has first choice and the interval to elapse between the return of one Partner and the next Partner to take leave. Financial arrangements whilst a Partner is on leave.
 - (iii) Maternity and Paternity Leave.
 - (iv) Provision for the manner in which notices are to be given to Partners for the purposes of the Partnership Agreement.

17. Arbitration and alternative dispute resolution

Partnership Agreements relating to professionals quite often provide that any dispute between Partners is to be referred to a private arbitrator to preserve confidentiality, rather than have the dispute heard in public by a Court. Other methods of alternative dispute resolution such as mediation and conciliation also have the advantage of avoiding publicity and can often lead to a quicker and less costly resolution of disputes.

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