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How Do Partnerships Operate?

Starting a partnership may be a high-yielding decision whether you are in the business game or setting your sights on a new business venture.

A partnership business structure is an incorporated business with 2-20 owners. The individual owners work together to achieve the business's goals, sharing responsibility and profits.

In a partnership, control or management of the business is generally shared. A partnership is not a separate legal entity, so you and your partners are liable for all debts and obligations of the business. A formal partnership agreement is standard but not essential (it is a recommended course of action).

The specifics of partnership laws will vary depending on your state or territory.

There are two types of partnerships – general and limited. A general partnership is where all partners are equally responsible for the day-to-day management of the business.

Whereas a limited partnership has at least one general partner who is responsible for controlling the day-to-day operations and is liable for the debts and obligations of the business.

The passive partners in this type of partnership are called limited partners. Limited partners generally contribute a defined amount of capital, and their liability is limited to the amount of capital that is contributed.

Consider the following advantages and disadvantages before starting or joining a partnership:

Advantages

A partnership structure is easy and inexpensive to set up. Unlike operating as a sole trader, there is increased opportunity for income splitting, more capital available and higher borrowing capacity.

Working as a team can also provide more perspective than working as an individual. High-performing employees can also be made partners.

From a tax perspective, partnerships do not need to pay taxes on their income. Each partner pays tax on the share of the net partnership income they receive. Paying superannuation is the responsibility of each individual partner, as partners are not considered employees.

Additionally, there are limited external regulation and reporting requirements.

Removing partners is generally straightforward. The only condition is that at least two partners are left in the business. If a partner wishes to resign from the partnership, it is relatively simple to dissolve the partnership and recover their share.

Disadvantages

This type of business structure carries unlimited liability, meaning the business owners are liable for the business's debts. They are subject to reasonably cover what is owed or risk seizure of their personal assets.

Each partner is responsible for the debts and liabilities of the business (with the extent depending on the type of partnership), including the actions of other partners.

This can cause disputes and friction among partners, resulting in unfavourable circumstances. For example, one partner may have a different vision or opinion on administrative control or profit sharing for the business compared with the other partners.

Although adding and removing partners is simple, partners will most likely need to value partnership assets which can be expensive.

If choosing to structure a business as a partnership, it is important to consult with an advisor to ensure that it is done correctly and compliantly to maximise the benefits (such as concessions, liability etc.) that could be infringed upon otherwise.

If you're not certain of where or how to start your partnership, come speak with us as your business advisers. We're ready and willing to help.