# Conducting Business as a Partnership

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## Partnerships Generally

Legally speaking, a partnership is:

The relation which subsists between persons carrying on a business in common, with a view of profit; but the relationship between members of an incorporated company or association is not a partnership within the meaning of this Act.

This is the definition of a partnership taken from the act in Manitoba that governs partnerships, known as *The Partnership Act* (the "Act"). This definition tells us a partnership must have multiple persons (i.e. it cannot be a sole proprietor), and these persons must seek to have a profitable business. A partnership may incur losses, but profit must be the goal.

Further, the legal definition of "partnership" sets a partnership apart from a corporation. It is explicit that a partnership cannot be the same thing as a corporation. Individual corporations may be partners within a partnership, but a partnership itself is not a corporation.

## Obligations for the Partnership

A partnership must be registered under *The Business Names Registration Act*. This registration must include the full name and residence of all partners, the general nature of the business being carried on, the name under which the partnership operates and the length of time the partnership has existed. Any subsequent changes in the membership of the partnership must be declared within 30 days of the change taking place.

In addition to registering the business name, the partners will need to determine whether they will have to register for GST and/or RST. Partners are strongly recommended to seek accounting advice regarding taxation of the partnership.

## Partnership or Incorporation?

In a corporate framework, the corporation pays low rates of taxation on its profit. The low rate of taxation is seen as a deferral of taxes paid. Paying low initial rates of taxation allows the corporation to pay down debt or reinvest the extra savings. The "full amount" of taxation will be paid at a later date, when the money is paid to the shareholders.

 

Partnerships do not have a comparable tax deferral system. Often a partnership will be used as an intermittent step prior to incorporation. Once incorporated, assets or partnership interests can be rolled over to the corporation. Alternatively, a partnership can be the end state for business organization, and business will continue to be conducted as such until the wind-up or sale of the business.

A benefit of a partnership is that it does not have the associated maintenance costs that a corporation has, such as the need to file annual resolutions and returns.

Forming a partnership versus incorporating will each have their own start-up costs. Individuals need to undertake a cost-benefit analysis to determine what the right vehicle for financial success is for them. There is no one-size-fits-all approach to business organization.

When making a business organization decision, attention should be paid to both the short-term and the long-term consequences. This includes considering the costs to maintain the structure, initial setup, administrative costs and potential liability.

**Profit and Property**

Subject to an express or implied agreement stating otherwise, all partners are entitled to share equally in the capital and profits of the business and must contribute equally towards the losses, whether of capital or otherwise.

A partnership agreement can dictate that profits are to be shared in certain proportions. Similarly, unless explicitly stated otherwise, losses will be shared in the same profit-sharing proportions.

Unless an agreement states otherwise, no partner shall be entitled to remuneration for acting in the partnership business. It is a rule of the law of partnership that a partner cannot charge for extra services rendered during the continuance of the partnership.

The tax allocation for a partnership is based on contribution, which, absent an agreement stating otherwise, will be assumed to be equal amongst the partners. At the partnership level, expenses are subtracted from revenues to determine the profit for a year. Those profits are then allocated to the individual partners, who pay the taxes on those profits.

The Act states that all property and interests in property originally brought into the partnership stock or acquired in the course of the partnership business are called “partnership property.” Partnership property must be held and applied by the partners exclusively for the purposes of the partnership and in accordance with the partnership agreement.

**The Need for a Partnership Agreement**

 

Many governance aspects of a partnership will default to the provisions of the Act unless otherwise addressed. Therefore, prudent management of a business operating as a partnership requires a properly drawn partnership agreement.

Similar to the effect a unanimous shareholders' agreement has for a corporation, a partnership agreement can provide considerable peace of mind for the partners in case there is a dispute or unforeseen circumstances arise in the future. Amongst other things, the partnership agreement can address cash calls between the partners, the admission of new partners, and what would happen in the event of the death or major disability of a partner or a breakdown in the relationship between the partners.

A partnership agreement is essential to maintaining the partnership and preventing the automatic dissolution of the partnership. Under the terms of the Act, the death, bankruptcy or insolvency of any partner will automatically dissolve the partnership. Further, the Act provides that a single partner can dissolve the partnership by giving notice to the other partners of the intention to dissolve the partnership. This freedom can be dangerous for business operations in the event of internal friction amongst the partners.

A partnership agreement drafted by a lawyer can be viewed as a form of insurance policy that is created to protect the partners' individual interests in the event of issues in the future.

## Rollover of Assets into a Partnership

Subsection 97(2) of the *Income Tax Act* states that an individual may roll over capital property or inventory to a partnership on a tax-deferred basis. The individual and all other members of the partnership must elect to do so under a prescribed form. If utilizing a rollover under subsection 97(2), the corporate rollover provisions of subsection 85(1) will apply to a partnership, as they do to a corporation. If no election is made, subsection 97(1) will deem the individual to have disposed of the property at fair market value.

## Exit Strategy

At the termination of a partnership, the *Income Tax Act* allows flexibility in the reorganization of business affairs so that deemed dispositions can be avoided. Capital property of a partnership can be moved on a tax-deferred basis to a sole proprietorship, a new partnership or a corporation. Each of these new forms of business must be a continuation by a former partner in order for the rollovers to apply.

If a partnership is to be sold, it will most likely take the form of a sale of assets. Potential third-party purchasers are not usually inclined to purchase partnership units or partnership interests. Purchasers are usually looking to create a new tax situation for themselves rather than inheriting tax problems.

Mason Broadfoot works in corporate commercial law with the firm. If you are interested in learning if a partnership is right for your organization or are ready to register a partnership, **please contact Mason**.

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