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Texas Uniform Partnership Act - The Enacted Version

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TEXAS UNIFORM PARTNERSHIP ACT —THE ENACTED VERSION

by

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THE first Article in this series[1] surveyed the common law of partnership in Texas and recommended adoption of the Uniform Partnership Act. A sequel[2] reviewed the Act in the form developed by a committee of the Texas Bar for presentation to the Texas Legislature. This Article reports the adoption of the Act and comments upon the changes made since the second Article. The format here is the same as in the second Article, *i.e.*, verbatim sections of the Act followed by comments. Any section not reproduced here was enacted as it appeared in the second Article. Non-substantive changes are noted in the margin.[3]

The act was introduced early in the 57th Legislature as S.B. 119, sponsored by Senator Wardlow Lane, and as H.B. 48, sponsored by Representatives Robert E. Johnson and B. H. Dewey, Jr. Hearings were held on February 14, 1961, by the House Committee on the Judiciary and on February 15, 1961, by the Senate Committee on State Affairs. At the hearings, the only witnesses were representatives of the State Bar of Texas, speaking in favor of the bill.[4] The Senate bill (in a substitute version correcting typographical errors) was reported favorably out of Committee on February 28, 1961, and passed March 6, 1961. The House bill was reported favorably out of Committee. House action was, however, taken on the Senate bill

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This Article is the third in an extended series on partnership law in Texas. The first two Articles in the series are cited by the author in the first and second footnotes of this Article. Reprints of the Articles are available from the *Journal*.

[1] Sher & Bromberg, Texas Partnership Law in the Twentieth Century—Why Texas Should Adopt the Uniform Partnership Act, 12 Sw. L.J. 263 (1958).

[2] Bromberg, The Proposed Texas Uniform Partnership Act, 14 Sw. L.J. 437 (1960).

[3] In § 13, the spelling of "therefore" was corrected to "therefor". Colons were inserted immediately preceding the following provisions (in lieu of commas, periods, or no punctuation marks): 16(1)(a), 33(1), 34(a), 35(1)(a), 35(1)(b)(I), 35(2)(a), 35(3)(a), 35(3)(c)(I), 39(a). Minor changes in verbiage and punctuation were made in the emergency clause, § 47. A severability clause was inserted as § 44. Sections 44-46 as they appeared in the second Article were renumbered §§ 45-47.

[4] Alan R. Bromberg from the Committee on the Uniform Partnership Act, W. Harry Jack from the Board of Directors, and Barefoot Sanders from the Legislative Committee. These three constituted an ad hoc committee for day to day implementation of the State Bar's sponsorship of the bill in the Legislature. Their testimony at the hearings followed the pattern of Bromberg, The Texas Uniform Partnership Act, 23 Tex. B.J. 713 (1960).

which the House passed on March 9, 1961, deleting by amendment a comma which had been inadvertently inserted in the Senate bill.[5]

Before the Senate had time to concur in the excision of the comma, objections were raised by attorneys for the medical profession. They felt that the bill, if enacted, would prejudice their ability to form associations with the tax advantages of corporations.[6] The bill was at an impasse, since the Senate declined to act in the face of the doctors' hostility. After considerable consultation and correspondence between the legal and medical spokesmen, they finally agreed upon the language contained in section 6(3). At this time, leaders of the legal profession felt that language might be added to protect any tax advantages that lawyers might presently have, and sections 16(3) and 18(2)-(3) were drafted for this purpose. The revised bill, bearing the blessing of the two professions, went back to the legislature. A Conference Committee was appointed on April 17, 1961. It reported favorably; the revision was passed by both chambers on May 9, 1961, and signed by the Governor on May 16, 1961. It is designated as Laws 1961, Ch. 158, and codified as Tex. Rev. Civ. Stat. Ann. art. 6132b.

THE REVISED SECTIONS

§ 6. Partnership Defined.—(1) A partnership is an association of two or more persons to carry on as co-owners a business for profit.

(2) But any association formed under any other statute of this state, or any statute adopted by authority, other than the authority of this state, is not a partnership under this Act, unless such association would have been a partnership in this state prior to the adoption of this Act; but this Act shall apply to limited partnerships except in so far as the statutes relating to such partnerships are inconsistent herewith.

(3) An association is not a partnership under this Act if:

(a) The word "association" or "associates" is part of and always used in the name under which it transacts business, and

(b) Its assumed name certificates, filed in accordance with law, contain a statement substantially as follows: "This association intends

[5] Ironically, the comma persisted despite watchful proofreading. It remains in the final bill in § 41(1) in the phrase "or to one or more of the partners, and one or more third persons". In all probability, the revisions reported in this Article would never have come about if the House had not attempted to remove this intrusive punctuation mark.

[6] The primary advantage here is the use of deferred compensation pension and profit-sharing plans. Partnerships may have such plans, but partners are excluded from benefits under them since they are not "employees." Rev. Proc. 61-11, § 2.02, 1961-18 Int. Rev. Bull. 53; Rev. Rul. 61-157, para. 2(e)(1), 1961-35 Int. Rev. Bull. 1, 9; I.T. 3350, 1940-1 Cum. Bull. 64; P.S. 23, P-H Pension & Profit Sharing Rep. para. 12,522 (Sept. 2, 1944). Cf. Elwin S. Bentley, 14 T.C. 228 (1950), aff'd. without opinion, 184 F.2d 668 (2d Cir. 1950), cert. denied, 340 U.S. 943 (1951) (no deduction for partnership contribution to plans whose beneficiaries included persons held to be partners). It seems odd that administrative determinations of so important a matter have not been tested in court. The answer lies in the practical necessity for an advance ruling on plan qualification.

not to be governed by the Texas Uniform Partnership Act," and
(c) The business it transacts is wholly or partly engaging in an activity in which corporations cannot lawfully engage.

This subsection shall not be construed to change in any way the law applicable to associations which are not partnerships under this Act.

COMMENT. Paragraphs (1) and (2) are unchanged. Paragraph (3) was added to preserve any tax advantages that unincorporated associations might have if not governed by the Uniform Act. Some associations desire the attributes of corporations and corresponding treatment as corporations under the tax law.[7] However, the Internal Revenue Service proclaims that associations organized under the Uniform Partnership Act cannot achieve such corporate features.[8]

Paragraph (3) allows associations to exclude themselves from the Act. The requirements (in (a) and (b)) are objective and affirmative in order to prevent inadvertent exclusion. These provisions also give some constructive notice to persons dealing with an excluded association. Its name serves as a signal, and the assumed name certificate (which is of public record) as a confirmation.[9] Subparagraph (c) limits the exclusion to organizations which cannot incorporate, *e.g.*, members of the learned professions. Enterprises which can incorporate may attain their tax aspirations that way, and have no claim to the limbo here created between corporation and partnership.[10]

What law governs associations which elect exclusion from the Act? Are they partnerships, joint stock companies, business trusts or something else? This question cannot be answered with certainty. Presumably, they are partnerships, governed by the common law

[7] Int. Rev. Code of 1954, § 7701(a)(3) and Regulations thereunder. Cf. United States v. Kintner, 216 F.2d 418 (9th Cir. 1954); Galt v. United States, 175 F. Supp. 360 (N.D. Tex. 1959); Ray, Corporate Tax Treatment of Medical Clinics Organized as Associations, 39 Taxes 73 (1961).

[8] Treas. Reg. §§ 301.7701-2(b) through (e). My personal view is that Texas common law is not materially different from the Act in the respects found controlling by the Regulations: continuity of life, centralization of management (dubiously construed not to exist if each partner can bind the other to third persons), limited liability, and free transferability of interests. If anything, the Texas Act provides more corporate characteristics than either the original Uniform Act or the Texas common law; §§ 27, 28-B and 31(4) permit greater transferability of interests and continuity of life. Accordingly, I think such associations are little, if any, better off outside the Act than within it. The sole case to the contrary, Galt v. United States, supra note 7, preceded the Regulations and contains no analysis whatsoever of the characteristics permitted by Texas law.

[9] Assumed name certificates are governed by Tex. Rev. Civ. Stat. Ann. arts. 5924-27 and Tex. Rev. Penal Code arts. 1067-70.

[10] So far in 1961, there has been a rush to solve the problem more directly: by authorizing professionals to incorporate. At least nine states have passed such laws: Ark., Conn., Fla., Ga., Minn., Ohio, S. Dak., Tenn., and Wash. Bills are pending in many others. See P-H Corporation Rep. Par. 2, 5 (July 19, 1961). Medical spokesmen in Texas were not enthusiastic about this approach. Among other things, they felt that corporate practice would complicate professional ethics and doctor-patient relationships.

previous to the Act. However, elaborate agreements and bylaws designed to procure corporate tax attributes may change their character under local law. The first Article in this series demonstrated considerable disarray in the common law of partnership. Probably, there is even more in the law of other unincorporated associations.[11] Consequently, organizations should think carefully before claiming exclusion from the Act. Not only may they find their expected tax benefits illusory;[12] they may also find their structural law inchoate. Whatever the controlling law may be, the last sentence of section 6(c) was inserted to prevent its disturbance by implication.

§ 16. Partner by Estoppel.—(1) When a person, by words spoken or written or by conduct, represents himself, or consents to another representing him to any one, as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in a public manner he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consenting to its being made:

(a) When a partnership liability results, he is liable as though he were an actual member of the partnership;

(b) When no partnership liability results, he is liable jointly with the other persons, if any, so consenting to the contract or representation as to incur liability, otherwise separately.

(2) When a person has been thus represented to be a partner in an existing partnership, or with one or more persons not actual partners, he is an agent of the persons consenting to such representation to bind them to the same extent and in the same manner as though he were a partner in fact, with respect to persons who rely upon the representation. Where all the members of the existing partnership consent to the representation, a partnership act or obligation results; but in all other cases it is the joint act or obligation of the person acting and the persons consenting to the representation.

(3) A representation that a person is an "associate" or a "non-partner member" of a partnership is not a representation that he is a partner in the partnership.

COMMENT. Paragraphs (1) and (2) are the same as in the second Article. Paragraph (3) has been added to make it clear that

[11] The only statutes on unincorporated joint stock companies have been codified with partnerships, Tex. Rev. Civ. Stat. Ann. Title 105, Ch. 2, arts. 6133-38. These deal mainly with procedural aspects of suits against such companies. See also 25 Tex. Jur. 169-232 (1933 & Supps.) (Joint Stock Companies and Business Trusts), 6 Tex. Jur. 2d 517-46 (1959) (Associations and Clubs). There have been few cases in these areas in recent decades. The earlier law has probably atrophied as corporations became easier and safer to use.

[12] See note 8 supra.

a person declared to be a non-partner under authority of section 18(3) does not become a partner by estoppel.[13]

§ 18. Rules Determining Rights and Duties of Partners and Employees. —(1) The rights and duties of the partners in relation to the partnership shall be determined, subject to any agreement between them, by the following rules:

(a) Each partner shall be repaid his contributions, whether by way of capital or advances to the partnership property, and share equally in the profits and surplus remaining after all liabilities, including those to partners, are satisfied; and must contribute toward the losses, whether of capital or otherwise, sustained by the partnership according to his share in the profits.

(b) The partnership must indemnify every partner in respect of payments made and personal liabilities reasonably incurred by him in the ordinary and proper conduct of its business, or for the preservation of its business or property.

(c) A partner, who in aid of the partnership makes any payment or advance beyond the amount of capital which he agreed to contribute, shall be paid interest from the date of the payment or advance.

(d) A partner shall receive interest on the capital contributed by him only from the date when repayment should be made.

(e) All partners have equal rights in the management and conduct of the partnership business.

(f) No partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs.

(g) No person can become a member of a partnership without the consent of all the partners.

(h) Any difference arising as to ordinary matters connected with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between the partners may be done rightfully without the consent of all the partners.

(2) By written agreement, the partners may establish various classes of partners (such as "senior partners," "junior partners," "managing partners" and others) and may provide for their varying rights and duties in relation to the partnership.

(3) By written agreement, the partners may establish various classes of non-partner employees (such as "associates", "non-partner members" and others) and may provide for their varying rights and duties in relation to the partnership.

COMMENT. Section 18(1) is identical with section 18 as it appeared in the second Article. Paragraphs (2) and (3) have been added. Paragraph (2) sanctions arrangements found in many large

[13] See also Comment under § 18 infra.

professional firms containing several classes of partners. It is merely declaratory of existing practice. Paragraph (3) is designed, like section 6(3), to make accessible certain income tax advantages. It recognizes that certain persons (who may, for example, have seniority and be compensated by a share of the profits) can by agreement be classed as employees. As such, they probably qualify for pension and profit-sharing deferred compensation under the Internal Revenue Code.[14]

The proposal was made that "members" be used in paragraph (3). However, this phrase had to be narrowed to "non-partner members" in order to avoid conflict with section 9 and others which use "member" as a synonym for "partner." It was also feared that general usage to this effect would create confusion in the minds of the public if a "member" were legally different from a "partner."

Conforming changes were made in the caption of section 18 and in the heading to Part IV.

For clarity, a comma was inserted after "property" in section 18(1)(a).

§ 27. Assignment of Partner's Interest.—(1) A conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership, nor, as against the other partners in the absence of agreement, entitle the assignee, during the continuance of the partnership, to interfere in the management or administration of the partnership business or affairs; it merely entitles the assignee to receive in accordance with his contract the profits to which the assigning partner would otherwise be entitled and, for any proper purpose, to require reasonable information or account of partnership transactions and to make reasonable inspection of the partnership books.

(2) In case of a dissolution of the partnership, the assignee is entitled to receive his assignor's interest.

COMMENT. This section is identical with the version in the second Article except that the words "to make" have been inserted before "reasonable inspection" near the end of paragraph (1). The meaning is thus a little clearer.

§ 45. Effective Date.—This Act shall take effect and be in force from and after January 1, 1962.

COMMENT. The version in the second Article contained an immediate effective date. The revision postpones effectiveness until January 1, 1962, in order to permit broader dissemination of the new law and better acquaintance with it before it becomes operative.

[14] See note 6 supra.

CONCLUSION

The passage of the Partnership Act is another example of the productive collaboration of attorneys, scholars and legislators under the auspices of the State Bar of Texas. The benefits of a sound jurisprudence and clear statutes will be felt throughout the community. It is hoped that the bar and bench will recognize the changes that have been made and will not cling to outmoded features of the common law.