



Excerpted from
FastTrac® TechVenture™



TAKE CHARGE OF YOUR BUSINESS®

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Partnership

A *partnership* forms when two or more entities join together for a common business purpose. A partnership can be *general* or *limited*. Although no written document is required to form a partnership, for all partners' sakes a partnership agreement should be written.

This document should spell out matters such as:

- Division of profits.
- Division of assets.
- Dissolution of the partnership.
- Payment or performance of partnership obligations.
- Ownership of intellectual property.

The partners control a partnership according to their agreement. They have a great deal of flexibility. If they have no other agreement, the law assumes that partners share control equally. In a limited partnership, the general partner controls the operations and the limited partner is simply an investor.

Some experts recommend avoiding any form of doing business that splits ownership 50/50. What happens if the owners do not agree? Nothing. A majority cannot be achieved. Instead of a 50/50 ownership, a third party in whom the owners have complete trust could have a very small percentage of ownership or a written agreement to resolve tie votes. If the owners agree, that person never hears from them. If the owners cannot agree, this third party votes so the business can act.

Partnerships have a fairly simple tax structure. Income and loss earned by the partnership passes through to the partners, and they report it on their respective tax returns. The partners then pay the tax on their share of the profits. The partnership itself does not pay any tax on profits.

Some authorities strongly advise against using the general partnership form of organization for most types of businesses because liabilities are personal and unlimited. Moreover, each partner is fully personally liable for the actions of any other partner. In a limited partnership, only the general partner is personally liable. The limited partner's liability is limited to the amount of investment.

Since a partnership is a voluntary association, you or any partner can end it at any time. Partners can simply say they no longer wish to be a partner. Unless the partnership agreement provides otherwise, the death of a partner also automatically ends a partnership.

Reality Check

A creditor will usually seek to collect from the partner with the most accessible assets. If you are that partner, seeking reimbursement from the partners who did not pay can be a long and sometimes futile process.

Partnerships

A biotechnology partnership in California was initially funded by three equal partners. The partnership contracted to have the technology developed with a university partner. It then planned to sell the technology to a pharmaceutical company. The investment was primed to reap huge profits for the partners; however, when the development costs exceeded the initial estimates and the partners were called upon to make additional contributions, only one of them had the funds to do so. Since the partnership had already contracted with the pharmaceutical company, everything would be lost if they did not complete the project. The one with the funds purchased the interests of the other two partners for far less than their initial investment and made all the profit himself when the technology eventually sold. The partnership structure wasn't right for the two partners who had to sell at a loss. Under a different structure, they might have been able to maintain their share in the company and then had the entity raise the needed funds.

A partnership is primarily dependent upon the individual assets of the partners to raise additional capital. Adding investors requires converting from a general to a limited partnership. It would create a new entity. Lenders will look for a fully collateralized loan to be personally guaranteed by the partners. Since limited partners are generally investors whose liability is limited to their investment, it is unlikely that they would be willing to personally guarantee a loan.

Key Points about Partnerships

- Owned by two or more entities in any combination (people, corporation, other partnerships) in either "general" or "limited" form.
- Controlled according to partnership agreement (law assumes equal control among partners if no agreement). In a limited partnership, the general partner controls and the limited partner is only an investor.
- Income and loss passed through to individual partners—the partnership itself does not pay taxes on any profit. Each partner may be separately liable for debts of the business.
- Each partner is legally liable for the actions of any other partner. In a limited partnership, the limited partner is liable only up to the amount of their investment.
- Can be sold as business or you can close it and sell assets if all partners agree according to a written agreement.
- A partnership agreement can provide for new partners, retirement, resignation, and continuation.
- Ends upon death of a partner unless otherwise provided for in partnership agreement.
- General partnerships are restricted in their ability to raise capital from external sources. Limited partners can invest.