



GENERAL PARTNERSHIPS

INTRODUCTORY OVERVIEW

A general partnership is the shared ownership of a business by two or more people. Like a sole proprietorship, there is no legal separation between the business and the individual partners. Although general partnerships are relatively easy to form, the simplicity of their structure often comes at the cost of a significant amount of risk.

A general partnership allows each partner to act independently, pool resources, avoid high startup costs, and avoid large amounts of formalities. However, the partners must be able to accept potentially unequal contributions of time and resources, fully trust the business judgment of every other partner, and be willing to take on the risk of being fully and personally responsible for the business's debts and liabilities. Also, each person should bear in mind that there is no default structure for resolution of partner conflicts. That is, no one individual's decisions govern any of the other partners unless a customized partnership agreement says so. Additionally, any partner can enter into a binding contract on behalf of every other partner; therefore it is critical to establish a strong decision-making policy within the organization.

HOW A GENERAL PARTNERSHIP IS FORMED

The most typical method of partnership formation is by agreement among the partners. Forming a general partnership is as simple as filing a form with the Clerk of the Circuit Court in the county in which the business will be located and paying a relatively small fee. After registering the business name with the state, the partners should draft and sign a partnership agreement that lays out the terms under which the partnership will operate.

Partnership agreements, though not legally required, are highly encouraged and are discussed more fully below.

Unlike many business entities, a general partnership can be formed unintentionally by showing proof of existence or by “estoppel.” Estoppel occurs when a person’s actions or statements lock him or her into a situation. That is, if two people behave like business partners even without using that label, they may end up being treated as though they had been operating under a general partnership despite the fact that neither individual intended to actually form a separate business entity. When two or more persons operate the same business together over time they may actually be operating a partnership without realizing it. Despite this possibility, most partnerships are formed intentionally.

After forming the business, there are a number of subsequent considerations to address. However, these issues are common to all types of business entities. For instance, employers need an Employer Identification Number from the IRS, which can be obtained using Form SS-4, through www.irs.gov, or by calling the IRS at (800) 829-4933. If the business has more than three employees, it must carry worker’s compensation insurance.

Partnerships are, in essence, merely joint ownership of a business or company. The partners share the rewards of business ownership equally, but at the cost of what may be an uncomfortable amount of risk. However, by customizing the terms of the partnership, each member can enter into the business fully knowing what to expect.

ADVANTAGES OF GENERAL PARTNERSHIPS

A well-crafted partnership agreement is an important risk management tool. This document allows wide flexibility in choosing the terms that will govern a partnership. The agreement can (and should) contain provisions regarding the degree and type of expected contributions of each partner, profit allocation, partner resignation or death, partnership dissolution, and any other concerns specific to the business. Because partnership agreements form the foundation of the business and outline the basic rules of operation, they should be drafted with care. If the agreement becomes complicated, it may be wise for each partner to have his or her own attorney review it independently.

General partnerships have several key advantages. First, each partner has the ability to act independently of the other partners, which enables the business to respond quickly to problems by lowering the amount of red tape involved in decision-making. Second, when forming the business, one partner can contribute one type of resources (for example, a plot of land) while the other contributes another type (for example, money). Third, partnerships have low startup costs and few formalities, as discussed above.

General partnerships are among the simplest forms of business structures, including their treatment for taxation. A partnership must report its income for tax purposes, but the

business entity is not taxed separately. Instead, profits are passed directly to each partner in accordance with the partnership agreement. Each individual is then taxed normally on his portion of the partnership's profits. Profits may be allocated freely under the partnership agreement, allowing income to be shifted to those partners in the lowest tax brackets.

DISADVANTAGES OF GENERAL PARTNERSHIPS

The terms of a general partnership are relatively simple because a general partnership is one of the simplest ways of sharing ownership of a business. Unless a partnership agreement states otherwise, both the profits and the losses of the business are shared equally by all partners. Losses include not just debts but also liabilities, including any legal actions against the business. Also, the actions of any individual partner are effective against the business as a whole. For example, if one partner purchases a new pickup truck without the authorization of any of the others and then hits a parked car while delivering a customer's package, the business and every partner is responsible for not only the purchase price of the vehicle but also any liabilities arising from litigation against the business. Every partner is "jointly and severally liable," meaning that not just the business but also each individual partner is fully responsible for satisfying every debt. Even though the other partners disagreed with the truck purchase, they still have to pay for it in addition to any of the damage it subsequently caused.

Note that unlike a limited liability entity, a general partnership has "unlimited liability," meaning that it does not shield the partners from any risks. Thus, each individual may have to use personal assets or resources to satisfy any debts owed by the partnership. Debts can be incurred by any partner without the approval of any of the others, so it is critical to trust each partner's business judgment before entering into a general partnership. Taking part in a general partnership means that you agree to let every other partner make decisions on behalf of you and the business, and that you agree to take full responsibility for those decisions.

COSTS OF FORMATION AND MAINTENANCE

Formation of a general partnership requires no fee if it operates under the legal names of the owners. No partnership may operate in Virginia under a fake, or "fictitious," name until it registers that name with the Clerk of the Circuit Court for the county in which the business is located.

Registration requires a fee, which is typically less than \$20. There are no on-going costs to maintain the existence of a general partnership.

LIFE AND DEMISE OF A GENERAL PARTNERSHIP

One of the many reasons that partnership agreements are critical to the success of a partnership is that without one, the entity is subject to a set of default rules. For instance,

upon the death or resignation of any partner the partnership automatically dissolves, requiring any partner(s) remaining to re-form the business. Fortunately, this default rule can be altered by agreement. Common arrangements include the buy/sell provision and the right of first refusal. If a partner dies or becomes disabled, the partnership agreement should detail whether and how the others may purchase the former partner's share. The right of first refusal allows other partners to purchase the share of a voluntarily withdrawing partner under previously agreed-upon terms.