What Is A Partnership?

In a partnership, two or more people own a business together.

The partners can share ownership however they want. But as with a sole proprietorship, the law does not distinguish between the business and its owners.

It is critical that there be a legal agreement that details, among other things:

1. What each partner's contribution will be, both in terms of time spent on the business and capital contribution.

2. What each partner's share of ownership will be.

3. How profits will be shared.

4. How disputes will be resolved.

5. How future partners will be admitted.

6. How an existing partner can be bought out.

7. What steps will be taken to dissolve the partnership if that becomes necessary.

Legal advise should be sought in drawing up the partnership agreement.

Advantages of a partnership include:

1. Partnerships are relatively easy to establish – but spend adequate time developing the partnership agreement.

2. With more than one owner, the ability to raise funds may be increased.

3. The profits from the business flow directly through to the partners' personal tax returns.

4. Prospective employees may be attracted to the business if given the incentive to become a partner.

5. A business usually will benefit from partners who have complementary skills.

Disadvantages of a partnership include:

1. Partners are jointly and individually liable for the actions of the other partners.

2. Profits must be shared with others.

3. Since decisions are shared, disagreements can occur.

4. Some employee benefits are not deductible from business income on tax returns.

5. The partnership may have a limited life; it may end upon the withdrawal or death of a partner.

There are several types of partnerships that can be considered.

General Partnership

Partners divide responsibility for management and liability, as well as the shares of profit or loss according to their internal agreement. Equal shares are assumed unless there is a written agreement that states differently.

Limited Partnership and Partnership with limited liability

"Limited" means that most of the partners have limited liability (to the extent of their investment) as well as limited input regarding management decisions, which generally encourages investors for short-term projects, or for investing in capital assets. This form of ownership is not often used for operating retail or service businesses. Forming a limited partnership is more complex and formal than that of a general partnership.

Joint Venture

Acts like a general partnership, but is for a limited period of time or a single project. If the partners in a joint venture repeat the activity, they will be recognized as an ongoing partnership and will have to file as such, and distribute accumulated partnership assets upon dissolution of the entity.

Federal tax forms needed by a partnership would include:

1. Partnership Return of Income - form 1065

2. Partner's Share of Income, Credit, Deductions - form 1065 K-1

3. Depreciation - form 4562

4. Individual Income Tax Return - form 1040

5. Supplemental Income and Loss - Schedule E

6. Self-Employment Tax - Schedule SE

7. Estimated Tax for Individuals - form 1040-ES

This article is intended to be used as an introduction and a guideline. Seek professional assistance before making a decision about how to structure your small business.