Business Development Session 11 - Developing a Partnership Agreement: Certificate of Limited Partnership LP-1 and Securities Filing 25102(f)

Partnership agreements can be as simple as a letter between the partners or a 30 page legal document. At a minimum, they should state how much each partner is contributing, how profits will be divided, when profits will be paid, and how partners can be bought out or leave the partnership. In addition, you should discuss procedures that you will follow if things go wrong or there are disagreements.

In this section you will find:

1. **Information about forming a partnership agreement**
2. **Sample partnership agreement (we will fax or mail it to you at your request)**

Before you prepare legal documents

1. Know your partners well. A partnership is like a marriage. You must be able to work together and communicate well because you are liable for each other's actions (even if you were not aware of what they were doing).
2. Discuss with your partners their expectations-especially how you will solve problems if things go wrong. Here are some things to consider:
    - What will each partner contribute: cash, property, experience, etc. What percentage of profits will each partner get?
    - Will one (or more) active partners get paid a minimum amount first (the equivalent of a salary), before the other partners are paid?
    - If the business' profits are less than the active partner's minimum compensation, will the other partners contribute money?
    - When will profits be distributed?
    - Who will keep the books? Will the other partner have the right to choose an outside bookkeeper to review (or keep) the books? Are separate books and bank accounts required (so that personal and business funds remain separate)?
    - If the business needs more cash, what percentage will each partner be responsible for?
    - What will you do if there is a disagreement between partners? One suggestion is to choose a third person (or have an attorney choose that person) to resolve the problem.
    - If one partner wants to leave the partnership, you want them to leave, or married partners are divorced, how will you compensate the person leaving? You will probably need to determine the business' overall value and that partner's contribution to it (this may be different from the ownership percentage). One suggestion is for both partners (or an attorney) to choose an outside business appraiser to determine an equitable settlement.
    - When should the active partners report to or consult with the other partners? Will a business plan or other reports be required?
    - What will you do if in a year, a partner thinks the partnership agreements are unfair?
    - Partners are personally liable for business debts. Do all the partners have similar amounts at risk if the business turns sour? If not, should the partners with the most at risk have a higher profit percentage to compensate them for that risk?
3. Review the sample partnership agreement to see if it covers all the areas that you have thought about. Discuss any concerns you have with an attorney and then finalize the partnership agreement.
4. Review your partnership agreement annually. Does it still make sense and is it still equitable? If

not, contact your attorney to help you revise it.

Keep good records

Before beginning business, get a good record keeping system which tracks all payments from and to your partners. These funds are not partnership income or expenses. Your system must also distinguish "guaranteed" payments to partners (for their services or for a return on their investment) from profit distributions to all partners. For tax purposes, you must also keep separate any payments for organizing (or syndicating) the business.

Warning

General partners are personally liable for the actions (or debts) of any other general partner. As an example, if one partner purchased one million cases of popsicles, let them melt, and then skipped town, the other partner would be responsible for the debt - even if the partner had no knowledge of it.

Limited liability companies (LLCs) were designed to give protection against this situation. LLCs provide all the flexibility of partnerships, but provide the same limited liability protection as corporations have. The downside is that LLCs have $800 in additional state taxes each year. If you are interested in forming an LLC, you can order a kit over the internet at http://www.businesskit.com or call the California Chamber of Commerce at 800-331-8877.

There is no homework for this session.