

15.3: Partnerships

A **partnership** is an unincorporated association of two or more co-owners who operate a business for profit. Each owner is called a **general partner**.

General Partnerships

A **general partnership** is when all partners participate fully in running the business and share equally in profits and losses, even if the partners' monetary contributions vary. No legal documents are required to file with the government to form a partnership. If two or more people do business together, sharing management of the business, profits and losses, they have a partnership.

If a partnership is formed formally, then the written agreement is called the **articles of partnership**. The articles can set forth anything the partners wish to include about how the partnership will be run. Normally, all general partners have an equal voice in management, but as a creation of contract, the partners can modify this if they wish.

A general partnership is taxed just like a sole proprietorship. A partnership is a **flow-through tax entity**, where the partnership's income "flows through" the business to the partners, who then pay individual tax on the business income. The partnership may file an information return, reporting total income and losses for the partnership, and how those profits and losses are allocated among the general partners. However, an information return is usually not required.

General partnerships are also similar to sole proprietorships in unlimited liability. Every partner in the partnership is jointly and severally liable for the partnership's debts and obligations. This is a very unattractive feature of general partnerships. One partner may be completely innocent of any wrongdoing and still be liable for another partner's malpractice or bad acts.

General partnerships are dissolved as easily as they are formed. Since the central feature of a general partnership is an agreement to share profits and losses, once that agreement ends, the general partnership ends with it. In a general partnership with more than two persons, the remaining partners can reconstitute the partnership if they wish, without the old partner. A common issue that arises in this situation is how to value the withdrawing partner's share of the business. Articles of partnership therefore typically include a buy/sell agreement, setting forth the agreement of the partners on how to account for a withdrawing partner's share, which the remaining partners then agree to pay to the withdrawing partner.

Management Duties

Partners have a **fiduciary duty** to the partnership. This means that partners have a duty to act for the benefit of the partnership. In particular:

- Partners have an obligation of good faith and fair dealing with each other and the partnership.
- Partners are liable to the partnership for gross negligence or intentional misconduct. Partners are not liable for ordinary negligence.
- Partners cannot compete with the partnership.
- Partners cannot take opportunities away from the partnership unless the other partners consent.
- Partners cannot engage in conflicts of interest.

Limited Partnerships

In most states, owners can form a limited partnership. A **limited partnership** has both general partners and limited partners. As a limited partner, the most he or she can lose is the amount of his investment into the business, nothing more. Limited partnerships have to be formed in compliance with state law, and limited partners are generally prohibited from participating in day-to-day management of the business. This often occurs when someone invests money in the partnership but is not interested in running the business.

Advantages of Partnerships	Disadvantages of Partnerships
<ul style="list-style-type: none">• Easy to create• No formal documents or governmental filings required to start business• Flexibility in sharing management decisions• Allows for investment by limited partners to raise capital• Easy to dissolve	<ul style="list-style-type: none">• Flow-through tax entity (owner pays personal income tax on all business profits)• Unlimited liability• May be hard to value individual partner's share of business• Dissolution occurs any time a new partner is added or old partner leaves

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