

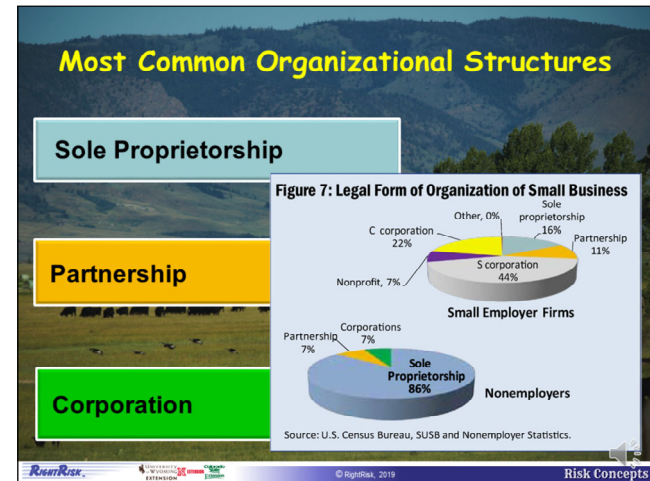


Hello and welcome to one in a series of RightRisk videos on business structures.

[click] There are a number of legal organizational structures to entrepreneurs. Today, I will focus on partnerships.

[click] I am Jeff Tranel, an agricultural and business management economist with Colorado State University. Joining me are [click] John Hewlett, a farm and ranch management specialist at the University of Wyoming and Doctor Jay Parsons, professor and extension specialist with the University of Nebraska – Lincoln. The three of us are also founding members of RightRisk.

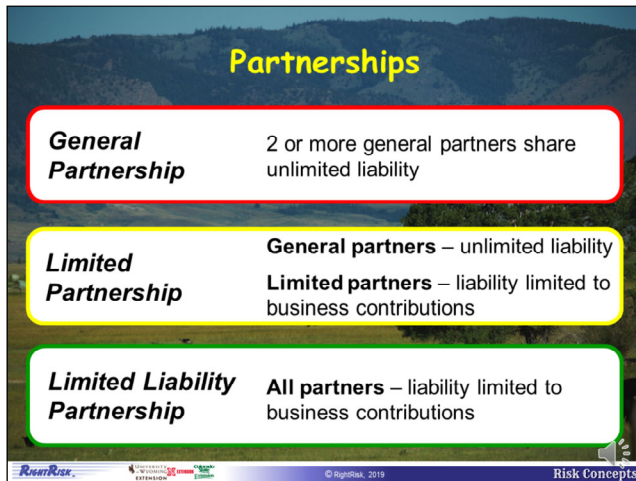
[click] [click]



[click] There are three basic types of business structures [click] – sole proprietorships, partnerships, and corporations. Each structure has advantages and disadvantages, different tax ramifications, alternative impacts to estate and succession plans, etc.

[click] According to the U.S. Census Bureau, 86 percent of all organizations are sole proprietorships. Partnerships and corporations each account for 7 percent of businesses. The percentage of firms being partnerships and having employees is slightly higher.

[click] [click]



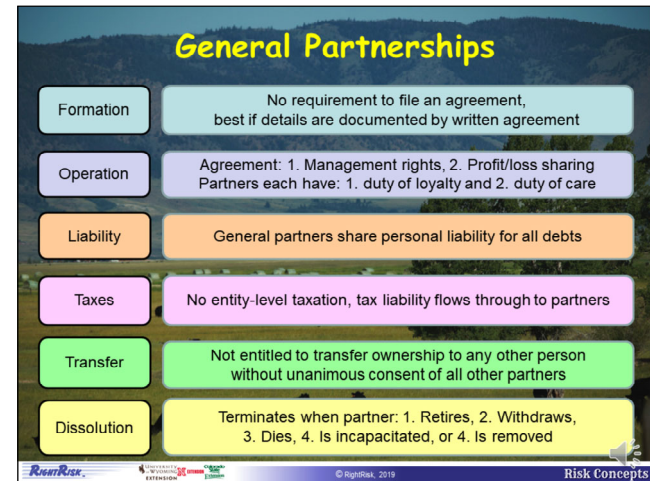
[click] There are three common forms of partnership.

[click] A general partnership is an association of two or more people who agree to carry on a business as co-owners for a profit. The partnership form of enterprise has been around for many years and is familiar to most legal, accounting, and other professionals.

[click] A limited partnership is a partnership with at least one general partner and at least one limited partner. It can only be formed by filing (usually with the Secretary of State) a written document which names the partners. The biggest distinctions between general and limited partnerships have to do with management rights and limited liability of the limited partners.

[click] A limited liability partnership is a general partnership where all partners have limited liability as to other partner's debts and liabilities. Except for a very few special provisions, it is subject to the same rules as a general partnership.

[click] [click]



[click] I want to now provide you with a few details about these three types of partnership. Let's begin with the general partnership.

[click] No particular formalities are required to form a general partnership. There are no filing requirements and the agreement to form a partnership need not be in writing nor contain any particular language. In fact, it is possible to form a partnership without ever using the words partner or partnership.

[click] The management rights of partners in a general partnership should be described in the partnership agreement. Absent such an agreement, it is assumed that all partners have the authority to obligate the partnership within the normal course of business.

[click] One of the most significant drawbacks to a general partnership is that all partners have personal liability for all debts of the business.

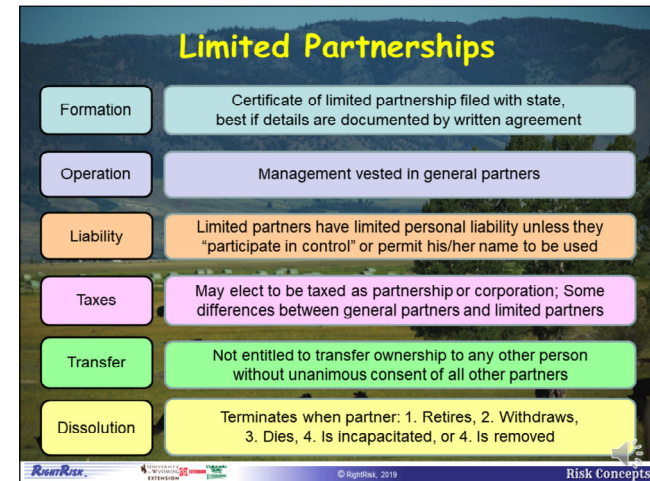
[click] There are no entity-level taxes imposed on partnerships. Each item of income and loss is passed through to the partners equally or in accordance with the partnership agreement. The partnership agreement may stipulate that (1) partnership profits or losses are shared among the partners in the same manner; (2) profits may be shared differently from losses; and/or (3) particular items of tax income, gain, loss, or deduction will be shared differently than overall partnership business profits and losses.

[click] A partner in a general partnership is generally not entitled to transfer all of the attributes of ownership to any other person, absent the unanimous consent of all other partners. The default rule

under original and revised statutes is that a partner can transfer his or her rights to profits and distributions but not any other rights traditionally vested in partners. Additionally, partners may admit new partners by unanimous consent or via any procedures provided in the partnership agreement.

**[click]** Ending a general partnership has three phases: dissolution, winding up, and termination. Dissolution begins when a partner voluntarily withdraws from the partnership (e.g. retirement or announces an intent to withdraw) or involuntarily (e.g. death, incapacity, or removal by the other partners). A partnership that has “dissolved” continues to exist for the purpose of “winding up” its business. “Termination” occurs when the winding up process is completed.

**[click]** **[click]**



**[click]** A limited partnership is a partnership in which there is at least one general partner and at least one limited partner. It can be formed only by filing a certificate of limited partnership with appropriate state officials. Unless the parties wish to abide by the default rules contained in the relevant statutes, much of what the partners agree will be contained in a partnership agreement. Some state do not require a written partnership agreement.

**[click]** Management of a limited partnership is vested in the general partners. Limited partners do not have management authority.

**[click]** Limited partners have a benefit not possessed by general partners – they have limited personal liability. If, however, a limited partner takes control of the business and a third party assumes the partner is a general partner, the limited partner loses his or her limited liability to the third party.

**[click]** Limited partnerships are among the entities that are entitled to elect whether to be taxed as partnerships or corporations. Unless the partners agree otherwise, profits and losses are presumed to be allocated on the basis of the value of the contributions made by each partner. There will, however, be some differences between the way that general partnerships and limited partnerships are taxed. One of the most notable of these differences, from an income tax perspective, is the different ways that allocations are taxed for purposes of self-employment taxes.

**[click]** A partner in any partnership is generally not entitled to transfer the attributes of ownership to any other person, absent the unanimous consent of all other partners. The default rule under the statutes is that a partner can transfer his or her rights to profits and distributions but not any other rights traditionally vested in partners. Partners may admit new partners by unanimous consent or via

any procedures provided in the partnership agreement.

**[click]** Dissolving a limited partnership is similar to the dissolution of other partnerships. One significant difference is that, generally, only general partners may supervise the process of dissolution.

**[click]** **[click]**

Limited Liability Partnerships	
Formation	General partnership must file application; application renewed annually in some states; may be minimum requirements
Operation	All partners have equal management authority; profits/losses shared equally unless partners agree differently
Liability	No personal liability for certain debts of the entity.
Taxes	No entity-level taxation, tax liability flows through to partners
Transfer	Not entitled to transfer ownership to any other person without unanimous consent of all other partners
Dissolution	Terminates when partner: 1. Retires, 2. Withdraws, 3. Dies, 4. Is incapacitated, or 4. Is removed

RiskRise, © RightRisk, 2019, Risk Concepts

**[click]** A limited liability partnership can be formed only by having a general partnership file an application with the appropriate state officials. The form is akin to the certificate of limited partnership for a limited partnership or articles of incorporation for a corporation.

**[click]** A limited liability partnership generally operates like a general partnership. All partners have equal management authority unless otherwise agreed upon. Absent any agreement by the partners to the contrary, all partners share equally in the profits and losses of the business.

The partners in an LLP are deemed to have a "capital account" equal to the value of all contributions to the partnership. It is the value of each partner's capital account – share of ownership – that typically determines the manner in which profits and losses are shared.

**[click]** The primary benefit of LLP status is that partners have no personal liability for certain debts of the entity. However, states are divided about the amount of protection from personal liability offered to general partners in such an enterprise.

**[click]** There are no entity-level taxes imposed on LLPs. Each item of income and loss is passed through to the partners equally or in accordance with the partnership agreement. If a tax related allocation is different from the owners' interest in the partnership, specific tax rules must be followed.

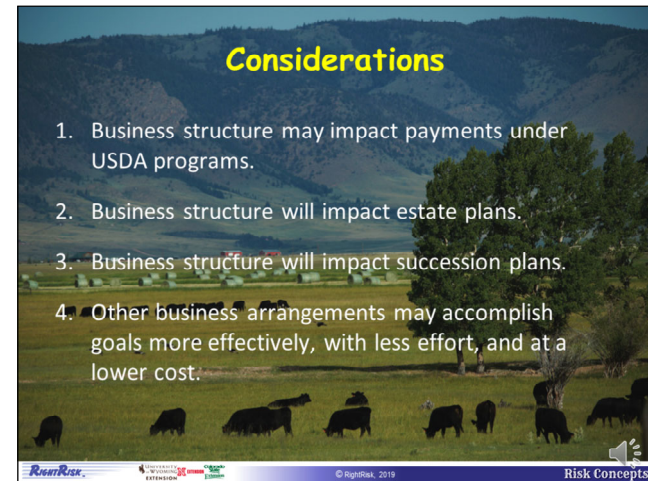
**[click]** A partner is generally not entitled to transfer all of the attributes of ownership to any other person. Unless the partnership agreement provides otherwise, a partner can transfer his or her rights to profits and distributions but not any other rights traditionally vested in partners. The person receiving the economic rights would have only very limited rights and no ownership nor management

rights.

Partners may admit new partners by unanimous consent or via any procedures provided in the partnership agreement. It is common to have partners pre-approve certain classes of transferees for admission to the partnership as partners, particularly family members of the original members.

**[click]** Dissolving a limited liability partnership is similar to the dissolution of other partnerships.

**[click]** **[click]**



**[click]** A person forming a business should consider all the factors which will impact the business and help him or her reach the desired goals. Professional counsel from an attorney, certified public accountant, and other knowledgeable professionals is critical before selecting a specific structure for the business.

**[click]** For example, a selected business structure may impact eligibility for and payments under various USDA programs.

**[click]** Likewise, a selected business structure will impact the owner's estate and succession plans. Each organizational structure allows one to implement certain strategies, but the impacts of those strategies may differ.

**[click]** Other business arrangements such as labor sharing agreements, livestock production contracts, and strategic alliances may allow a business owner to accomplish his or her goals more effectively, with less effort, and at a lower costs.

**[click]** **[click]**

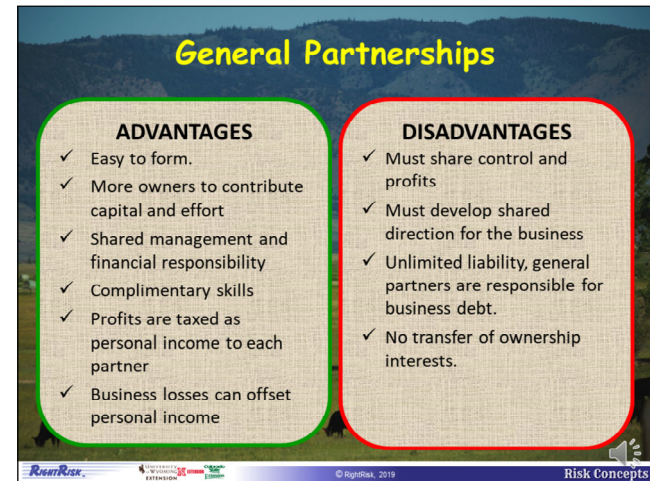




**[click]** Ideally, a partnership should be documented by a written agreement. The agreement will serve as a written record of the parties' actual agreement in the event of future disputes, imperfect memories, or the death of a partner. It will minimize the risk that the partners will be surprised by any default rules in existing partnership statutes. Also, a written partnership agreement will enhance communications between the partners and their families.

It is especially important to have a written agreement when there is any type of limit to a partnership such as with a limited partnership or a limited liability partnership.

**[click] [click]**



A general partnership has advantages and disadvantages to other forms of business structure.

**[click]** Advantages of a general partnership is that they are easy to form; multiple owners or partners increases the availability of contributed capital and the people able to manage the business and finances; profits are taxed as person income to each partners; and business losses can be used to offset personal income for tax purposes.

**[click]** On the other had, being involved in a general partnership means that control and profits are shared. The partners must agree to a shared direction for the business. Another disadvantage of a general partnership is that all owners have unlimited, personal liability for all debts of the partnership.

**[click] [click]**



Limited partnerships and limited liability partnerships have advantages and disadvantages over general partnerships and other organizational forms.

**[click]** Generally, LPs and LLPs are similar to general partnerships. They are easy to form, but registration with the state is required. They also provide for personal liability limitations against partnership business debts in most cases. It is important to note that only general partners are involved in the management of the business.

**[click]** On the other had, being involved in any partnership means that control and profits are shared. The partners must agree to a shared direction for the business. Another disadvantage of a all partnerships is that the partnership typically dissolves when any partner wants out of the business.

**[click] [click]**



**[click]** RightRisk has a plethora of resources available on its web site. Specifically, under the resources tab are written and other materials pertaining to organizational structures **[click]** titled Risk Concepts. You will find several 4-page fact sheets describing selected organizational structures and a **[click]** 2-page table comparing the attributes of seven most common organizational structures.

**[click] [click]**



In summary, there are a number of organizational structures available to business owners. Each structure has advantages and disadvantages, ramifications, and impacts to the business and to the owners.

**[click]** A general partnership is an association of two or more people who agree to carry on a business as co-owners for a profit. This flexible business form has several advantages and is well understood by most legal, accounting, and other professionals. Limited Partnerships and Limited Liability Partnerships are partnerships with either partners having limited authority and/or limited liability.

**[click]** Please look for information about organizational structures and additional educational resources at the RightRisk web site – [rightrisk.org](http://rightrisk.org). Thank you. Have a great day. **[click]**