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The Pros and Cons of Business Partnerships

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- A business partnership is a shared business venture between two parties.
- It can be an informal agreement, although you should always have a written contract.
- Business partnerships are great for financing, expertise and division of labor, but be wary of disadvantages like partner liability and conflicts of interest.
- **This article is for entrepreneurs and future business owners who are considering entering a business partnership.**

When starting a business, you may have the option to either go it alone or form a business partnership. Both options have advantages and disadvantages, and the best one for your business depends on your unique situation. We spoke with business owners and legal experts to map out what you should consider when evaluating a business partnership opportunity.

What is a business partnership?

A business partnership is formed when two or more parties come together to carry out a business venture, sharing both profits and losses. A business partnership can be formed by individuals and/or business entities (e.g., limited liability companies or corporations).

The terms of the partnership can take many shapes and forms. For example, a business partnership can occur when a pharmaceutical company takes on a development partner to develop a specific drug, said James Cassel, chairman and co-founder of Cassel Salpeter.

"A partnership can also consist of a musical artist partnering with a record company, or it can be a case where two people just decide to go into business together, or an attorney wants to partner with another attorney," Cassel told business.com.

Although it is possible to have a business partnership without a formal agreement, it is always wise to have a written contract with detailed terms.

Key takeaway: **A business partnership can be a shared business venture between two people or between two business entities.**

Types of business partnerships

There are four types of business partnerships you can enter: a general partnership (GP), limited liability company (LLC) partnership, limited liability partnership (LLP), and limited partnership (LP). Each partnership type has varying levels of liability and control.

General partnership

A general partnership is formed between two or more parties who run a business venture together. GPs don't require formal agreements or state registration, so they are easiest partnership to start. They offer tax flexibility; however, they don't offer personal liability protection, so you are responsible for the actions of your partners actions, and your personal assets are at risk.

Limited liability company partnership

A limited liability company partnership (also known as a multimember LLC) consists of two or more owners (individuals or corporations) who are referred to as members. In an LLC partnership, a member can be held responsible for another member's actions, but it does offer the added benefit of personal liability protection and tax flexibility.

Limited liability partnership

A limited liability partnership is a formal agreement between two or more individuals to run a business venture together. Owners of an LLP are protected from the actions of their partners, and they are not personally responsible if a lawsuit is filed against the business (excluding cases of personal negligence or malpractice). LLPs offer management and partnership flexibility, but they do not offer tax flexibility. In some states, only certain professions can form LLPs. This is something to investigate if you are operating in an unapproved profession in multiple states, as some may not recognize you as an LLP.

Limited partnership

A limited partnership consists of two or more partners, including at least one general partner and one limited partner. The general partner has control over business decisions and is personally responsible for the business. The limited partner (also known as a silent partner), though, does not make business decisions and is not personally liable. There is some tax flexibility with LPs.

Compare each partnership type to see which level of liability and control suits your needs. When evaluating partnership types, it is important to be mindful of the state rules and regulations that apply to your business type.
Key takeaway: **You can enter a general partnership, limited liability company partnership, limited liability partnership or limited partnership, depending on state guidelines and the level of liability and control each partner wants.**

How are business partnerships formed?

Matt Odgers, attorney at Odgers Law Group, said a partnership can be unintentionally formed based on the actions of the partners, unlike other business entities that require state fees and registration documents (such as articles of incorporation).

"While strongly recommended, a partnership does not require a written agreement, and it can be formed based on an oral agreement or based on the actions and relationship of the partners," said Odgers.

It is always best to clearly communicate what your intentions are when working with someone else. If you decide you would like to officially partner with that person or organization, Odgers advised drafting a partnership agreement, applying for a tax ID number, and filing a statement of partnership with your state government.

Key takeaway: **Partnerships can be created through formal written contracts or informal agreements*.***

Business partnership taxes

Partnerships are generally taxed as pass-through entities, meaning that each partner reports their share of the income and expenses on their personal tax returns. Because of this, partners who own more shares of a business are responsible for paying more in taxes.

"The partnership will file a Form 1065 with the IRS, and each owner receives a Schedule K," said Odgers. "The Schedule K spells out that owner's share of the income and expenses from the partnership. The owner then uses that information when filing their own taxes."

Key takeaway: **Partnership taxes are reported on each partner's personal tax returns, according to their ownership shares in the company.**

Pros of business partnerships

A business partnership can be a desirable option for many reasons. The core benefits pertain to funding, taxation, division of labor, and knowledge.

- **Access to capital.** Perhaps the most obvious advantage to having a business partner is splitting the finances. Starting and running a business is an expensive venture, and when you share the financial responsibilities of a business with another individual or entity, you are at a greater advantage of getting your business off the ground. Partnering with one or more other business members (regardless of partnership type) can increase financial security and cash flow, and lower the stress of funding your operation.
- **Taxation.** Another advantage to a partnership is taxation. Most business partnerships are taxed as pass-through entities. Because of this, you file

and pay taxes on your share of business ownership. This can reduce the burden of paying taxes on the entire business yourself.
- **Division of labor.** Just as partners can split the financial burden of a business, they can split the responsibility of operations as well. A business partner is someone you can share day-to-day business operations and major business decisions with (unless you operate under a limited partnership). Splitting up the responsibilities and duties of your business can help with efficiency and productivity, enabling you to accomplish more than you would alone. If you have a problem with your business, you have someone to consult with.
- **Knowledge and expertise.** Every business owner brings unique experiences and skills to the table. When you operate your business with a partner, you can benefit from their knowledge and expertise. It is ideal to have a business partner that excels in areas where you are lacking. Additionally, if you are a first-time entrepreneur, it can be beneficial to partner with a seasoned business owner who can help guide the business.

Key takeaway: **The benefits of business partnerships include additional funding and expertise, tax benefits, and division of labor.**

Cons of business partnerships

Operating a business with someone else is not always easy, and sometimes it can end terribly if you are not properly prepared. There are a few challenges to be aware of, primarily regarding profit, liability, and conflicts of interest.

- **Informal arrangement.** Partnerships allow for great flexibility, but this can be a problem as well. When setting up a partnership, it might be easier to just settle on a verbal agreement, but it is always best to sign a clear, written agreement for protection. Coming to terms about the percentage of ownership, liability, and responsibility can be difficult to agree on, which can cause setting up a partnership to take more time and money than you might have anticipated.
- **Lower percentage of the profit.** In contrast to the benefit of having additional funding, a business partnership can also yield lower profit per person. Since you will be dividing the profit of the business based on share of ownership, you must be okay with not receiving the full income that the business brings in.

- **Partner liability.** Depending on the type of business partnership you enter, you may be personally responsible for any actions brought against the company. You also may be liable for a mistake your partner makes. Liability is a big factor in partnership, so it is important that you trust your potential partner and enter a partnership that protects your best interests.
- **Conflict.** When you are running a business with someone else, you are bound to have occasional differences in opinion. If you and your partner have different work ethics, or have a disagreement you can't resolve, your business can suffer immensely. This is especially true in cases of partnerships with family members or close friends, where personal issues can cloud professional judgement.

Key takeaway: **The disadvantages of business partnerships can include lower profit percentages, added partner liability and conflict.**

"While easy to form, partnerships can lead to a lot of trouble down the road if there is a disagreement or if litigation arises," said Odgers. "It is strongly recommended to work with an attorney to determine whether the partnership is your best option."